

EXHIBIT F

0:00:02.340,0:00:02.590
[Unofficial Transcript]

0:00:02.360,0:00:03.770
[Mr. McHenry] The committee will now come to order.

0:00:03.770,0:00:10.720
I will start today's hearing by reading the Oversight and Government Reform Committee's

0:00:10.720,0:00:12.140
Mission Statement.

0:00:12.140,0:00:17.929
We exist to secure two fundamental principles. First, Americans have the right to know that

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the money Washington takes from them is well spent. Second, Americans deserve an efficient,

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effective government that works for them.

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Our duty on the Oversight and Government Reform Committee is to protect these rights. Our

0:00:31.810,0:00:36.090
solemn responsibility is to hold government accountable to taxpayers because taxpayers

0:00:36.090,0:00:40.030
have a right to know what they get from their government.

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We will work tirelessly in partnership with citizen watchdogs to deliver the facts to

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the American people and bring them genuine reform to the Federal bureaucracy. This is

0:00:50.140,0:00:52.649
the mission of the Oversight and Government Reform Committee.

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Today, we are here for a joint hearing between the Oversight and Government Reform Subcommittee

0:01:06.889,0:01:13.889
on TARP, Financial Services and Bailouts of Public and Private Programs and the Subcommittee

0:01:16.429,0:01:21.609
on Government Organization, Efficiency and Financial Management on "SEC: Who's Watching

0:01:21.609,0:01:24.579
Wall Street's Watchdog."

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When we called this hearing originally, we were concerned about capital formation and

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accountability at the SEC. A number of management practices had come to light at that point

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that we thought it would be important to discuss, but a lot has changed just in the last two

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weeks in terms of disclosures of what is happening at the SEC and larger issues of concern with

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management that strike the agency's credibility.
So there will be a lot of questions to that

0:01:58.719,0:02:00.469
regard in today's hearing.

0:02:00.469,0:02:05.189
[Mr. McHenry] I welcome the panel. I thank
you for being here and with that, I yield

0:02:05.189,0:02:10.090
to the Chairman of the full committee, my
customary five minutes as Subcommittee Chair,

0:02:10.090,0:02:11.530
for his opening statement.

0:02:11.530,0:02:15.599
[Chairman Issa] I thank the Chairman and I
thank him for his generosity with the opening

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statement.

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I, too, thought this hearing would be about
slightly different matters, but in recent

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days, the committee has become aware of what
could be the greatest challenge to the SEC's

0:02:29.530,0:02:36.530
credibility since Bernie Madoff managed to
dup so many Americans, steal so much money

0:02:36.599,0:02:41.379
with his ponzi scheme, and escape the proper
scrutiny of the SEC for so long.

0:02:41.379,0:02:48.379
As we have learned, in 2009, the former General
Counsel, Mr. Becker, came to the SEC and informed

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the Chairman that he had a potential conflict
of interest. We hope to learn exactly how

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that was expressed, but in fact, he had received,
along with his siblings, \$2 million that came

0:03:07.780,0:03:14.780
from the liquidation of a Bernie Madoff fund
in 2005. That would be serious enough that

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anyone would normally consider that he should
be recused from any activity related to the

0:03:21.519,0:03:23.840
Madoff after action.

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Notwithstanding that, Mr. Becker, feeling
that this was, as we have understood it, a

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de minimis amount relative to his estate,
in fact, not only continued to be involved,

0:03:36.590,0:03:43.590
but was instrumental in having the SEC inserted
into the process of trying to change how the

0:03:45.069,0:03:52.069
determination of how much money would be considered
to be eligible to be retained by those who

0:03:52.510,0:03:58.400

got their money out before the collapse versus Pg 4 of 73
how much would be clawed back for the greater

0:03:58.400,0:04:02.819
good of all those involved and victimized
by the ponzi scheme.

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Had Mr. Becker's suggestions been taken,
in fact, Mr. Becker's mother's estate

0:04:10.150,0:04:16.410
of \$2 million would have benefited well all
those who were there to the end and lost so

0:04:16.410,0:04:19.660
much would have been victimized.

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The problem we are going to be probing in
this hearing, in addition to others, is can

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we trust an SEC where the process allows an
individual to inform the Chairwoman, to inform

0:04:31.949,0:04:37.789
the ethics individual who actually reports
to the General Counsel, and get effectively

0:04:37.789,0:04:44.630
a clean bill of health not to disclose and
not to recuse and even to be involved in an

0:04:44.630,0:04:51.090
action that had it been accepted, as our understanding
is, by the trustees, would have led to a distortion

0:04:51.090,0:04:55.650
of process in favor of Mr. Becker's family.

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We take Mr. Becker at his word that, in fact,
he intended no wrong. We are willing to take

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factually in 25 minutes, the ethics individual
at SEC made a determination there was no problem

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and stuck by it. We are willing to hear the
Chairwoman here today.

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What we are not willing to do, as the committee
that deals in waste, fraud and abuse, and

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as a committee of Congress, all of us being
concerned a great deal about the confidence

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in what the SEC represents in its oversight,
its fairness and its competence, we are not

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willing to accept that this can ever happen
again.

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Mr. Chairman, I am not going to presume any
facts not yet in evidence. So far, we only

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have a limited amount of reports, a clawback
procedure against Mr. Becker and Mr. Becker's

0:05:51.289,0:05:57.360
own interview here with some of our investigators.
Today, we have an opportunity to listen to

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the Chairwoman, to realize that she inherited
an organization that had no flaws, but her

0:06:05.690,0:06:10.810
independent agency has, in fact, been the
subject of the President's attention, her

0:06:10.810,0:06:12.310
attention.

0:06:12.310,0:06:19.310
We have not yet high confidence but high hope
that the SEC will live up to its mandate,

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not just of having a complex web of rules
that tell public companies that if their own

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child works for a company, they cannot be
outside or independent officers or directors

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of the company, or, for example, what a conflict
is to the people who oversee, who can be on

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the compensation committee, who cannot. It
is a complex business but it relies on a belief

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that the rules are necessary, they are implemented
in a sensible way, uniformly and that they

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are for a purpose.

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I believe as we look further into the Becker
matter, we are going to find the SEC failed

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to have the highest level of fear so that
public confidence could be maintained. I can

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find no way out of this. I hope today we at
least understand how this mistake came to

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happen.

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Mr. Chairman, once again, thank you for holding
this important hearing and I yield back.

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[Mr. McHenry] Thank you, Mr. Chairman. Thank
you for your statement. With that, I recognize

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the distinguished member from Illinois, the
Chairman of the Subcommittee on TARP, Financial

0:07:22.780,0:07:25.509
Services and Bailouts of Public and Private
Programs, Mr. Quigley, for five minutes.

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I am sorry, I just promoted you to Chairman
-- Ranking Member, Mr. Quigley.

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[Mr. Quigley] Thank you so much, Mr. Chairman.
I soon will be joined by Chairman Platts,

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as well.

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I thank our witnesses for their time today Pg 6 of 73
and their contributions.

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As we all know, in December of 2008, Bernard Madoff was arrested for running the largest

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ponzi scheme in American history. Losses from Madoff's fraud have been estimated at \$18

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billion, devastating the savings of many Americans.

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We all know the SEC missed Madoff despite being tipped off on several occasions. Although

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no regulatory agency should be expected to be perfect, a failure of this magnitude is

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clearly unacceptable.

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How did this happen? Many have blamed the SEC's outdated technology, which is woefully

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behind what the financial firms are using; many have blamed the SEC's silo problem

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which prevents coordination among the SEC's many offices. Another culprit that has been

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cited is the SEC's workforce which some argue includes too many lawyers and not enough

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industry veterans. We have all heard about the SEC employees viewing pornography instead

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of doing their jobs. These are reasonable concerns and all merit oversight from these

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two subcommittees.

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We have also heard about a potential conflict of interest from David Becker, formerly Senior

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Counsel at the SEC. It is my understanding that SEC IG David Katz is investigating this

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matter. I look forward to his report.

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Just a few years removed from Madoff and the worst financial crisis since the Great Depression,

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we need the SEC to do its job and do it well. The SEC is Wall Street's policeman. It was

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estimated by the 1934 Security Exchange Act to prevent fraud and abuse in the securities

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market. Creating the SEC was essential to restoring investor trust in our country's

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economic system. If our economic system is

going to work, says Nobel laureate, Joseph Pg 7 of 73

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Stiglitz, then we have to make sure that what people gain when they cheat is offset by a

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system of penalties.

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Each year, the SEC brings hundreds of enforcement cases against firms that have sold fraudulent

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financial products. In 2010, for example, the SEC brought 681 enforcement cases against

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1,800 defendants.

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Just as all of us feel more comfortable in our neighborhoods when they are well policed,

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investors feel more comfortable buying financial products when the SEC is doing its job and

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prosecuting white collar crime. The SEC is more important today than ever before. Trust

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in our financial system is at its lowest ebb and this lack of trust is impeding our economic

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recovery.

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The financial regulatory reform law passed here was a step in the right direction, but

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it alone is insufficient. Laws have to be enforced and the SEC needs to be a strong

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enforcer.

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Unfortunately, the House-passed budget would reduce SEC funding from its current \$1.1 billion.

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For comparison's sake, City Bank spent \$1.6 billion on marketing alone in 2010. How is

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the SEC expected to police Wall Street when its entire budget is less than the marketing

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budget of one Wall Street Bank?

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In a May 2010 report, the Minority staff of the Oversight Committee found that the Commission

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security disclosure procedures are technologically backward. Yet, under the House-passed cuts,

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the SEC won't be able to continue any improvement of its IT systems. If the SEC's budget is

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reduced to 2008 levels, as some have proposed, the SEC would have to layoff 600 workers.

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My point is this. Just a few years after the Madoff incident and the worst financial crisis

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in recent history, should we really be talking about taking 600 cops off Wall Street? Let

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us strengthen the SEC, not weaken it. Let us also ensure that the SEC undertakes common

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sense report to avoid past mistakes.

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Put another way, after 9/11, despite our intelligence failures, we did not cut the intelligence

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budget, we doubled it. It is my understanding that the SEC has already reorganized, brought

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in a COO and designed a new tips referral system. These are all commendable steps.

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In the end, our country will be safer from another financial crisis if the SEC is well

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organized and well funded.

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I look forward to hearing from our witnesses who I hope will provide some constructive

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ideas on how to improve the SEC's oversight of financial markets.

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Thank you. I yield back.

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[Mr. McHenry] I thank the Ranking Member.

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With prior agreement on our side, Dr. Gosar from Arizona will have five minutes for an

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opening statement.

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[Mr. Gosar] Thank you, Mr. Chairman.

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Let me preface my comments with the following. I am not a financial analyst, I am not an

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accountant and I am not a lawyer, but I do have skin in the game, as do most Americans.

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Most Americans are compelled to invest in the markets through their employer-sponsored

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retirement plans whether they are 401(k) plans or public or union pension plans. The money

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largely goes to Wall Street.

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The public needs assurances that those who handle our money and our retirement futures

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are playing by the rules and are being fair
and are honoring their fiduciary responsibilities

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and obligations.

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The public assurances come from the Securities
Exchange Commission. The SEC is supposed to

0:13:08.740,0:13:14.450

be guarding the hen house. This hearing raises
troubling questions. Who is watching the hen

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house -- the fox or the guard?

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Mr. Chairman, recent news reports have focused
on David Becker's conflict of interest,

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but this hearing is not about a single incident.
This problem is actually far deeper and goes

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to the very heart of management practices
at the SEC.

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Every organization needs a set of mechanisms
to prevent or detect fraud, waste or mismanagement.

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These are commonly known as internal controls.
It would appear that internal controls at

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the SEC are not functioning properly.

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One, the Government Accounting Office tells
us that the SEC is unable to reliably track

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its finances because it cannot control its
own financial reporting. Two, the SEC's

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Inspector General tells us that 30 employees,
including an assistant regional director,

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viewed sexually explicit materials at work
and only one was actually fired. Was anyone

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else ever disciplined? Three, now the news
media tells us that the SEC's General Counsel

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was allowed to advise the Commissioners on
the Madoff case when he had a personal, financial

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interest.

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All these matters represent a breakdown in
oversight and management, a failure of internal

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controls. The sad irony is that the SEC is
the Federal agency in charge of making sure

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publicly traded companies have effective internal
controls and public governance structures.

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In fact, Mr. Chairman, if these events happened at a publicly traded company, the SEC would

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be investigating itself and what would be the penalties?

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Federal agencies are subject to the Federal Managers Financial Integrity Act which dictates

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that they provide annual assurances to Congress that their internal controls are adequate.

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This law has been in effect since 1982 and governs not just financial management, but

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program management as well.

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The Federal Managers Financial Integrity Act is within this committee's jurisdiction.

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Therefore, this hearing has an important legislative and oversight purpose in the Commission's

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compliance with the law and others. Mr. Chairman, the anecdotal example of internal breakdowns

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are symptoms of a much larger systemic breakdown. Since there is no SEC to investigate the SEC,

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today I challenge my colleagues.

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Thank you, Mr. Chairman. I yield the balance of my time.

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[Mr. McHenry] I thank the gentleman.

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I now recognize the Ranking Member of the Subcommittee on Government Organization, Efficiency

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and Financial Management, Mr. Towns, former Chairman of the full Committee, for five minutes.

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[Mr. Towns] Thank you very much, Mr. Chairman, and thank you for holding this hearing today.

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The SEC is at an important crossroads. It is successfully emerging from a troublesome

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period leading up to collapse of the country's financial system. It is paused to take the

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lead in reforming Wall Street and preventing another financial meltdown through its enforcement

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of the Dodd-Frank Act.

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This hearing will example financial management, the workforce and internal operations at the

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SEC. It is encouraging to see all the new

initiatives Chairman Schapiro has put in place Pg 11 of 73

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in the last two years. The SEC hired its first Chief Operating Officer to oversee the accounting

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functions, financial reporting and internal controls, and we salute you for that, Madam

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Chair.

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The SEC has also hired a new Chief Information Officer to oversee its information technology

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functions. The Chairperson has restructured the entire Enforcement Division, recruited

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experts and has put a new governing structure in place. This is commendable as well.

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As with any organization, lapses can, do and will occur. I understand the SEC has taken

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disciplinary action against those who have been accused of misconduct at the Commission

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and that greater accountability has been integrated into the disciplinary process.

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The SEC is responsible for safeguarding the confidence of American investors in the financial

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markets and I hope our hearing today will help our financial watchdog fulfill its mission.

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I now yield the balance of my time to the Ranking Member of the full Committee.

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[Mr. Cummings] I thank the gentleman for yielding.

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This committee is responsible for ensuring that our government operates effectively and

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efficiently. That means holding public officials to the highest standards, demanding excellence

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at every turn and eliminating even the appearance of impropriety.

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Today, the committee intends to examine against David Becker, the former General Counsel of

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the SEC. I do not know Mr. Becker, I have never met him, never talked to him, and the

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Minority was excluded from Mr. Becker's interview when Chairman Issa's staff interviewed

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him, but I do want to make sure that everyone who comes before this committee is treated

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fairly, including Mr. Becker, Chairwoman Schapiro
and others.

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If I understand the facts correctly, Mr. Becker's parents invested about \$500,000 with Bernie

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Madoff in 2000. Mr. Becker's mother died in 2004 and when her funds were divided among

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Mr. Becker and his two brothers in 2006, they had increased to about \$2 million.

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Mr. Becker joined the SEC in 2009, he notified the SEC officials about his inheritance and

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when issues arose relating to his inheritance, he sought advice from SEC ethics officials

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and received clearance to proceed. Some have suggested that Mr. Becker may have benefited

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financially from the SEC's later decisions, but it appears that the opposite may be true.

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The basic question the SEC faced was whether to support an asset valuation method used

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by the trustee representing the Madoff victims, called the cash-in-cash-out method, or a different

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valuation method proposed by several law firms called the last statement method.

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Under the first, Mr. Becker's inheritance would be subject to litigation to recover

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or clawback assets on behalf of the Madoff victims. Under the second, it appears that

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it would not. Based on the court filings, the SEC chose to support the first method.

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This meant that the trustee could sue Mr. Becker and his brothers to recover some of

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his mother's inheritance which is exactly what happened.

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Mr. Chairman, in your briefing memo for today's hearing, you acknowledged that the SEC's

0:19:48.639,0:19:54.669

decision was "actually detrimental to Mr. Becker's interest." Nevertheless, I have

0:19:54.669,0:19:59.850

serious questions about the conclusions of the SEC's Ethics Office, Chairman Schapiro,

0:19:59.850,0:20:06.149

that these issues had no effect on Mr. Becker's financial interest. Someone else of questionable

0:20:06.149,0:20:11.190

character might have tried to take advantage

of this situation. I also have questions about this situation. I also have questions about this situation.

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0:20:11.190,0:20:17.429

whether Mr. Becker's interests should have been disclosed more widely within the SEC

0:20:17.429,0:20:20.950

and I hope we can learn more about this process today.

0:20:20.950,0:20:27.950

I also invite my Republican colleagues to join us in making sure that the SEC has all

0:20:27.990,0:20:34.990

the resources it needs. There is a proposed cutting of \$148 million from their budget

0:20:35.110,0:20:38.999

and we do need a robust SEC.

0:20:38.999,0:20:44.249

Chairwoman Schapiro, I read what you have done and what you have accomplished. You inherited

0:20:44.249,0:20:50.090

a mess. You inherited an agency that Senator McCain said the former Chair should resign,

0:20:50.090,0:20:52.490

so we understand that.

0:20:52.490,0:20:56.139

Again, I am looking for a fair hearing and one where we can get to the bottom of all

0:20:56.139,0:20:56.620

of this.

0:20:56.620,0:20:57.720

I yield back.

0:20:57.720,0:21:01.480

[Mr. McHenry] I thank the Ranking Member.

0:21:01.480,0:21:04.899

All members may have seven days to submit opening statements for the record.

0:21:04.899,0:21:09.499

I will now recognize the panel. We have the Honorable Mary Schapiro, Chairman, Securities

0:21:09.499,0:21:16.499

and Exchange Commission; Mr. Jeffrey Rissing, Director, SEC Office of Human Resources; Mr.

0:21:19.360,0:21:25.129

Jonathan Jack Katz, the former Secretary of the Securities and Exchange Commission for

0:21:25.129,0:21:32.129

20 years; Mr. Stephen Crimmins, a securities attorney with K&L Gates -- he served as Deputy

0:21:34.269,0:21:41.269

Chief Litigation Counsel of the SEC's Enforcement Division from 1993-2001; and Ms. Helen Chaitman,

0:21:44.009,0:21:51.009

the attorney representing approximately 350 investors in Mr. Bernard L. Madoff's investment

0:21:51.049,0:21:53.570

securities firm.

0:21:53.570,0:21:58.580

It is the policy of the committee that all witnesses be sworn before they testify. Please

0:21:58.580,0:21:59.899

0:21:59.899,0:22:06.899

Do you solemnly swear or affirm that the testimony
you are about to give this committee will

0:22:09.259,0:22:12.980

be the truth, the whole truth, and nothing
but the truth?

0:22:12.980,0:22:16.009

[Witnesses respond in the affirmative]

0:22:16.009,0:22:20.950

[Mr. McHenry] The record will reflect that
all the witnesses answered in the affirmative.

0:22:20.950,0:22:22.649

With that, I thank you.

0:22:22.649,0:22:28.620

We will begin at this time with Chairman Schapiro.
I think you heard the members' opening statements

0:22:28.620,0:22:33.679

and we would love to hear your comments, especially
about this conflict that has been discussed.

0:22:33.679,0:22:34.539

Ms. Schapiro?

0:22:34.539,0:22:39.289

[Ms. Schapiro] Thank you very much, Chairman
McHenry, Ranking Members Quigley and Towns,

0:22:39.289,0:22:41.519

members of the Subcommittee.

0:22:41.519,0:22:45.039

Thank you for inviting me to testify today
regarding the financial management, workforce

0:22:45.039,0:22:49.139

management and internal operations of the
Securities and Exchange Commission. As you

0:22:49.139,0:22:53.809

know, I am joined by Jeff Risinger, Director
of our Office of Human Resources.

0:22:53.809,0:22:58.710

When I arrived at the SEC two years ago, the
agency was reeling from a variety of economic

0:22:58.710,0:23:05.529

events and mission failures and in need of
across the board reform. We needed more experts,

0:23:05.529,0:23:10.330

better training, improved communication among
our divisions and offices and an effective

0:23:10.330,0:23:15.820

strategy for handling tips and complaints.
These challenges were exacerbated by inadequate

0:23:15.820,0:23:21.169

infrastructure, material weaknesses in financial
management and a culture that had failed to

0:23:21.169,0:23:27.039

keep up with an increasingly complex financial
marketplace. We immediately and comprehensively

0:23:27.039,0:23:32.080

set out to change the way the Commission worked.
My written testimony details the reforms of

0:23:32.080,0:23:35.159

the last two years, but I would like to highlight
a few.

0:23:35.159,0:23:40.240

We brought new leadership and senior management to virtually every office and hired the Commission's

0:23:40.240,0:23:45.940

first Chief Operating Officer. We revitalized and restructured our enforcement and examination

0:23:45.940,0:23:51.679

operations and revamped our handling of tips and complaints. We broke down internal silos

0:23:51.679,0:23:57.240

and created a culture of collaboration. We recruited more staff with specialized expertise

0:23:57.240,0:24:02.619

and real world experience and expanded our training. We enhanced safeguards for investors'

0:24:02.619,0:24:06.690

assets through new rules and the leveraging of public accounting firms.

0:24:06.690,0:24:12.240

Although we have made significant progress, we continue to seek ways to improve our operations.

0:24:12.240,0:24:18.559

After all, our core responsibility is pursuing fraud, reviewing corporate disclosures, overseeing

0:24:18.559,0:24:23.119

the largest capital markets in the world and inspecting the activities of thousands of

0:24:23.119,0:24:27.820

financial intermediaries our essential to restoring investor confidence in the wake

0:24:27.820,0:24:29.869

of the financial crisis.

0:24:29.869,0:24:36.399

Our funding has presented challenges. From 2005 to 2007, the SEC experienced three years

0:24:36.399,0:24:42.549

of frozen or reduced budgets, forcing a 10 percent reduction in the agency staff. Similarly,

0:24:42.549,0:24:48.110

the agency's investment in new or advanced systems declined approximately 50 percent

0:24:48.110,0:24:50.240

between 2005 and 2009.

0:24:50.240,0:24:57.240

While SEC staffing levels are just now returning to 2005 levels, the securities markets have

0:24:57.549,0:25:03.480

undergone tremendous growth since then. Indeed, during the past decade, trading volume has

0:25:03.480,0:25:08.450

more than doubled, the number of investment advisors grew by 50 percent and the funds

0:25:08.450,0:25:15.450

they manage increased to \$38 trillion. Operating under the continuing resolution only exacerbates

0:25:15.509,0:25:19.559

the imbalance between our resources and the magnitude of our mission.

0:25:19.559,0:25:25.059

At the same time, the Dodd-Frank is significantly

0:25:25.059,0:25:30.149
the derivatives market, hedge fund advisors
and union support advisors. In addition, we

0:25:30.149,0:25:34.139
are also charged with enhanced supervision
of rating agencies, heightened regulation

0:25:34.139,0:25:39.009
of asset-backed securities and the creation
of a new whistleblower program.

0:25:39.009,0:25:42.869
For these reasons, I am concerned that without
additional resources, we will not be able

0:25:42.869,0:25:47.529
to fulfill these responsibilities in the manner
in which Congress intends and the American

0:25:47.529,0:25:49.950
people deserve.

0:25:49.950,0:25:53.509
Finally, I would like to address the issue
of former Counsel David Becker's role in

0:25:53.509,0:25:58.059
light of his mother's ownership of an account
at Madoff that was closed years before the

0:25:58.059,0:26:00.399
fraud was revealed.

0:26:00.399,0:26:05.909
Mr. Becker informed me, I believe shortly
after he arrived in 2009, that his mother

0:26:05.909,0:26:10.549
had an account with Madoff before she died
and that it had been closed a number of years

0:26:10.549,0:26:15.309
before he returned to the agency. It did not
strike me that his mother's account closed

0:26:15.309,0:26:20.480
years ago would present a financial conflict
of interest.

0:26:20.480,0:26:25.340
Mr. Becker was, and is, an experienced attorney
who had served as General Counsel under three

0:26:25.340,0:26:31.049
chairmen. I relied on him to present any ethics
related issues to the Ethics Counsel and follow

0:26:31.049,0:26:35.330
the Ethics Counsel's advice. I understand
that is what he did.

0:26:35.330,0:26:40.720
When I returned to the agency in 2009 having
served there in the late 1980s and early 1990s,

0:26:40.720,0:26:45.669
appointed by President Reagan and President
Bush, I read many letters from Madoff's

0:26:45.669,0:26:51.730
victims, people who have lost everything.
My entire focus was on how to fix the SEC

0:26:51.730,0:26:56.330
to ensure that another tragedy like Madoff
could never happen again, and how to make

0:26:56.330,0:27:01.169

sure within the contours of the Securities Pg 17 of 73
Investors Protection Act that we could get

0:27:01.169,0:27:05.269
the most money to people who were literally
losing their homes.

0:27:05.269,0:27:09.649
I am proud of how much we have accomplished
in the past two years working tirelessly with

0:27:09.649,0:27:14.399
an extraordinary staff to improve the operation
of the Commission and enhance the public's

0:27:14.399,0:27:18.549
perception of the integrity of our work and
the fairness of our decisions.

0:27:18.549,0:27:24.110
While Mr. Becker did solicit and follow advice
from the ethic's counsel, I realize in light

0:27:24.110,0:27:29.029
of this incident that as Chairman, I have
to ensure that we go beyond what may be required

0:27:29.029,0:27:34.330
in any particular situation. On matters like
these, I have to be looking around the next

0:27:34.330,0:27:40.129
corner, looking beyond the horizon and thinking
above and beyond what may be appropriate advice

0:27:40.129,0:27:44.570
from the Ethics Counsel to make sure nothing
occurs that could raise questions about the

0:27:44.570,0:27:46.940
Commission's mission or processes.

0:27:46.940,0:27:51.429
To ensure that this matter is fully reviewed,
I requested that the SEC Inspector General

0:27:51.429,0:27:56.580
conduct an independent review and analysis
of all of the relevant facts. In addition,

0:27:56.580,0:28:01.369
under the leadership of our new Ethics Counsel,
we have been performing a top to bottom review

0:28:01.369,0:28:03.159
of our ethics program.

0:28:03.159,0:28:06.820
In the meantime, I look forward to answering
questions about this matter to the best of

0:28:06.820,0:28:11.570
my recollection, but I can say to this committee
with assuredness, we will learn from this

0:28:11.570,0:28:18.570
experience and we will take all actions necessary
to earn the trust the public places in us.

0:28:18.669,0:28:19.129
Thank you.

0:28:19.129,0:28:20.320
[Mr. McHenry] Thank you, Chairman.

0:28:20.320,0:28:25.480
I would counsel the committee that the lights
before you, at one minute to go, it will turn

0:28:25.480,0:28:31.739
yellow and red means stop. With that, if you

could keep your comments to five minutes we Pg 18 of 73

0:28:31.739,0:28:32.139
would certainly appreciate it.

0:28:32.139,0:28:33.840
Mr. Risinger?

0:28:33.840,0:28:38.239
[Mr. Risinger] Mr. Chairman, I am happy to
be before the committee today. I look forward

0:28:38.239,0:28:42.409
to taking your questions. I don't have any
further statements.

0:28:42.409,0:28:47.960
[Mr. McHenry] Five seconds. That might be
a record. Thank you and congratulations.

0:28:47.960,0:28:48.769
Mr. Katz.

0:28:48.769,0:28:55.769
[Mr. Katz] Good afternoon, Chairman McHenry,
Chairman Platz, Ranking Member Quigley, Ranking

0:28:58.350,0:29:03.299
Member Towns, members of the two subcommittees.
It really is an honor to be invited to testify

0:29:03.299,0:29:05.929
on the operations of the Securities and Exchange
Commission today.

0:29:05.929,0:29:11.350
It is a matter of great interest and importance
to me personally because for most of my career,

0:29:11.350,0:29:17.019
I was an employee of the SEC. For 20 of those
years, I served as the Commission's Secretary,

0:29:17.019,0:29:21.549
which was one of those unusual positions that
afforded me a rare opportunity to participate

0:29:21.549,0:29:25.470
firsthand in virtually every aspect of the
Commission's responsibilities.

0:29:25.470,0:29:31.379
I retired from the Commission in January of
2006. In the five intervening years, I have

0:29:31.379,0:29:37.460
really been fortunate. I have served as a
technical advisor to a variety of securities

0:29:37.460,0:29:42.139
commissions in governments in emerging market
countries and have also had the opportunity

0:29:42.139,0:29:45.429
to speak and write about financial regulation
in the United States.

0:29:45.429,0:29:51.330
In 2008, the Center for Capital Market Competitiveness
at the U.S. Chamber of Commerce invited me

0:29:51.330,0:29:54.860
to conduct a study and to write a report on
how to improve the efficiency and effectiveness

0:29:54.860,0:30:01.860
of the SEC. I wrote this study based upon
interviews with more than 50 current and former

0:30:02.940,0:30:08.179
SEC staff persons and Commissioners who agreed

to be interviewed and gave me their ideas, Pg 19 of 73

0:30:08.179,0:30:12.909
insights and criticisms, the best of which
I shamelessly stole.

0:30:12.909,0:30:19.480
In addition to this report, in 2009, I wrote
a second article for the Pittsburgh Law Review.

0:30:19.480,0:30:24.989
This article focused primarily on the Enforcement
Division of the SEC, a subject that I did

0:30:24.989,0:30:29.860
not discuss in the Chamber report. Unlike
the Chamber report which reflected the collective

0:30:29.860,0:30:35.909
views of a wide range of people, this article
was really my own personal views. In both

0:30:35.909,0:30:41.369
documents, I attempted to constructively identify
what could be done to make the agency a more

0:30:41.369,0:30:45.379
effective capital market regulator.

0:30:45.379,0:30:49.769
Today, I am aware that one of the focal points
is, of course, the SEC's budget and question

0:30:49.769,0:30:56.769
of resources. I have to answer that I, like
most people, agree that the SEC does need

0:30:56.970,0:31:03.320
more staff to carry out its responsibilities,
but why more money and more staff is necessary,

0:31:03.320,0:31:10.320
I don't think it is sufficient. To do the
job well, the agency has to reexamine how

0:31:10.429,0:31:15.639
it does that job and I think it has to make
changes. I think it is time to critically

0:31:15.639,0:31:20.359
self examine the core functions and recognize
that most of them just haven't been very

0:31:20.359,0:31:21.940
effective.

0:31:21.940,0:31:28.909
My concern is that just having more people
do more of the same thing in the same way

0:31:28.909,0:31:34.480
is not the best solution. I think we need
fundamental changes in organization and management

0:31:34.480,0:31:39.940
and mission definition. Chairman Schapiro
has identified a number of the initiatives

0:31:39.940,0:31:42.600
she has undertaken and I commend her on them.

0:31:42.600,0:31:47.559
I worked for seven Chairmen and four Acting
Chairmen and I will tell you that with the

0:31:47.559,0:31:51.450
possible exception of John Schad, the first
Chairman I worked with, Chairman Schapiro

0:31:51.450,0:31:55.359
has probably focused more of her attention

0:31:55.359,0:32:00.509

the other intervening Chairmen, but again,
these are first steps and I think more needs

0:32:00.509,0:32:02.379
to be done.

0:32:02.379,0:32:09.379

I want to highlight five points that are contained
in my witness statement. I don't have time

0:32:10.210,0:32:13.659

to go through all of them but if people have
questions, I would be happy to do it.

0:32:13.659,0:32:19.289

I think the agency needs a partial reorganization.
I advocate what is referred to internationally

0:32:19.289,0:32:24.570

as the Twin Peaks approach, one division that
deals with all aspects of retail financial

0:32:24.570,0:32:30.759

services regulation and another division that
handles all credential functions, the so-called

0:32:30.759,0:32:35.179

safety soundness and stability functions.

0:32:35.179,0:32:40.499

I think the agency needs a Chief Operating
Officer. I applaud Chairman Schapiro for appointing

0:32:40.499,0:32:46.019

one, but I think you have to go further. You
need a Chief Operating Officer who really

0:32:46.019,0:32:50.509

is that and has more than the title. The way
I distinguish it is when you try and build

0:32:50.509,0:32:57.509

a house, the architect and owner design the
house, but you need a general contractor to

0:32:58.429,0:33:02.539

actually get it done, to build it well, to
keep you on budget and on time.

0:33:02.539,0:33:09.539

I see my time is almost up, so I will quickly
identify two other things. I think there needs

0:33:09.869,0:33:15.399

to be substantial changes in enforcement.
When you look at Madoff, you understand, in

0:33:15.399,0:33:20.070

my opinion, this was not a question of culpability,
a few bad people doing bad things.

0:33:20.070,0:33:25.989

Madoff is similar to other failures of the
Commission in the past. These are structural

0:33:25.989,0:33:31.220

issues that go with how the Division of Enforcement
frames its responsibilities and conducts those

0:33:31.220,0:33:38.220

responsibilities. It has to be proactive,
not reactive, and its results have to be aimed

0:33:38.859,0:33:44.200

at remediation, not penalties. Penalties are
the function of the Justice Department. In

0:33:44.200,0:33:50.830

that respect, I would advocate very strongly Pg 21 of 73
for beefing up a Criminal Securities Office

0:33:50.830,0:33:55.279
in the Department of Justice so that the agency
doesn't have to rely upon the Southern District

0:33:55.279,0:33:58.259
of New York which has limited jurisdiction.

0:33:58.259,0:34:02.159
Just in closing, I want to mention what I
think is the most important recommendation

0:34:02.159,0:34:09.159
of all, the need for a special study of the
securities markets. In 1961, the SEC was similarly

0:34:09.230,0:34:13.160
troubled, the markets were in similar upheaval.

0:34:13.160,0:34:18.780
Congress appropriated funds to create a special
study of the securities market. A group of

0:34:18.780,0:34:24.640
technocrats, experienced people in government
and from industry spent 18 months studying

0:34:24.640,0:34:31.640
the markets and studying how the SEC functioned.
They issued a five volume report that literally

0:34:31.820,0:34:38.419
for 25 years was the touchstone for everything
the SEC did. I think we need another one.

0:34:38.419,0:34:40.950
Thank you very much for the time. I am happy
to answer questions.

0:34:40.950,0:34:43.000
[Mr. McHenry] Thank you, Mr. Katz.

0:34:43.000,0:34:44.550
Mr. Crimmins, you are recognized for five
minutes.

0:34:44.550,0:34:48.060
[Mr. Crimmins] Thank you, Mr. Chairman.

0:34:48.060,0:34:52.450
Chairman McHenry, Chairman Platts, Ranking
Member Quigley and Ranking Member Cummings,

0:34:52.450,0:34:55.790
thank you for hearing us today.

0:34:55.790,0:35:00.830
Over the last decade, we have seen an explosion
and the size and complexity of our capital

0:35:00.830,0:35:05.950
markets, exponential increases in trading
volume, workers doing thousands of trades

0:35:05.950,0:35:11.310
in a few seconds instead of maybe a hundred
trades a day, high speed, computer driven

0:35:11.310,0:35:17.530
trading strategies, fragmentation of trading
away from the exchanges and into dark pools

0:35:17.530,0:35:20.950
and ECNs and 24/7 globalized stock trading.

0:35:20.950,0:35:25.940
We have seen investment products become so
complex that the sophisticated traders that

0:35:25.940,0:35:31.330

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trade them don't always fully understand what they are and scary systemic risk that

0:35:31.330,0:35:33.510
threatens recurring crises.

0:35:33.510,0:35:39.280
Now after the crash, we see many investors pulling out and staying out of stocks and

0:35:39.280,0:35:46.280
mutual funds. Investors are still scared and sidelined with their decimated 401(k)s. Investor

0:35:46.680,0:35:52.640
perceptions are critical. These people will be unwilling to continue to risk their capital

0:35:52.640,0:35:58.500
or risk their capital again if Wall Street's cop on the beat becomes the cop on furlough.

0:35:58.500,0:36:03.830
Last summer, in the depths of the worst financial crisis in 80 years, Congress recognized that

0:36:03.830,0:36:08.490
the Securities and Exchange Commission needed twice the budget to be relevant in today's

0:36:08.490,0:36:15.220
huge, complex and hyper-charged markets. Whatever issues anyone in Congress has with the SEC,

0:36:15.220,0:36:20.050
I would respectfully suggest that the answer is not to starve in the wake of the crash,

0:36:20.050,0:36:23.900
the answer is not to create an environment where it will be easier for the frauds just

0:36:23.900,0:36:24.920
to prey on investors.

0:36:24.920,0:36:30.580
Instead, the answer is for all of us, here and now, to commit firmly to do whatever it

0:36:30.580,0:36:36.910
takes to make the SEC the strong and smart overseer that our capital markets deserve

0:36:36.910,0:36:39.310
to recover and grow.

0:36:39.310,0:36:44.180
One thing is of paramount importance. Nobody is asking the taxpayer for one dime to fund

0:36:44.180,0:36:50.020
the SEC. What is often forgotten in the discussion is that American taxpayers pay absolutely

0:36:50.020,0:36:56.880
nothing to run the SEC each year. Under 1996 legislation adopted by a Republican Congress

0:36:56.880,0:37:02.760
and a Democratic President, the money to run the SEC comes entirely from Wall Street transaction

0:37:02.760,0:37:07.970
fees and assessments designed to cover the entire cost of the SEC's budget.

0:37:07.970,0:37:13.300
Because of this a substantially increased SEC appropriation paid for with this successful

0:37:13.300,0:37:19.600

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15-year old funding mechanism would require no tax dollars whatsoever and would add nothing

0:37:19.600,0:37:25.480

to the deficit. In short, the Wall Street user fee money is already there. Congress

0:37:25.480,0:37:28.640

just has to let the SEC use it to police Wall Street.

0:37:28.640,0:37:35.640

Madoff was a tragedy. The SEC missed Madoff and Chairman Schapiro and others have not

0:37:37.860,0:37:44.310

tried to evade or run away from that fact, but so did FINRA whose predecessor installed

0:37:44.310,0:37:49.130

Madoff as its Vice Chairman, and so did the Justice Department, and so did the New York

0:37:49.130,0:37:54.060

Attorney General with Madoff right in his own backyard, and so did how many others,

0:37:54.060,0:37:58.920

including the sophisticated financial services firms that regularly interacted with him.

0:37:58.920,0:38:04.860

Madoff was an industry icon and idol and nobody knew that he was really a crook.

0:38:04.860,0:38:11.240

Yet, through thick and thin, the SEC was out there bringing almost 700 complex cases for

0:38:11.240,0:38:16.860

enforcement every year against almost 2,000 defendants every year and with greater funding,

0:38:16.860,0:38:19.030

could have brought far more.

0:38:19.030,0:38:23.690

We hear criticism of the SEC's recently departed General Counsel, David Becker. His

0:38:23.690,0:38:29.510

power, I suggest, is misunderstood. He was not the Secretary of some Cabinet level department.

0:38:29.510,0:38:35.580

Instead, he was the General Counsel, one of multiple senior advisors at a five member,

0:38:35.580,0:38:41.830

bipartisan commission, composed of two Republicans, two Democrats and one independent.

0:38:41.830,0:38:46.790

Whatever his power, the point is that he did not use it to benefit himself. The month after

0:38:46.790,0:38:53.300

he left the agency still to this day, it remains unclear exactly how any of the Madoff related

0:38:53.300,0:39:00.070

claims are ultimately going to be calculated. In any event, the Madoff Trustee, Irving Packard

0:39:00.070,0:39:03.790

reports to the court, not to the SEC, and he will make his own decisions on what he

0:39:03.790,0:39:05.900

wants to claim.

0:39:05.900,0:39:10.380

Finally, we need some perspective. What we are talking about is whether the Dorothy Becker

0:39:10.380,0:39:16.590

estate will get to keep the \$500,000 that Dorothy originally invested or whether it

0:39:16.590,0:39:22.190

will also get to keep some small amount on top, the inflation adjustment. That seems

0:39:22.190,0:39:26.390

to be where this is all breaking down and being discussed.

0:39:26.390,0:39:31.660

The senior ethics official with whom Becker consulted ruled that whatever theoretical

0:39:31.660,0:39:37.150

conflict this may actually have presented, it did not create such a conflict that he

0:39:37.150,0:39:42.500

needed to recuse himself, based on what was known at that time. The possibility of a claim

0:39:42.500,0:39:48.420

against this estate of a particular type at some future date was at that time speculative.

0:39:48.420,0:39:51.690

Now we know more, of course.

0:39:51.690,0:39:55.030

[Mr. McHenry] Thank you for your testimony.

0:39:55.030,0:39:58.110

Ms. Chaitman, you are recognized for five minutes.

0:39:58.110,0:40:05.110

[Ms. Chaitman] Thank you so much for giving me this opportunity to speak to you. I speak

0:40:09.940,0:40:16.940

on behalf of approximately 500 Madoff investors whom I represent and I speak, as well, on

0:40:17.640,0:40:24.250

behalf of every American who hopes to save enough money in his lifetime to retire on

0:40:24.250,0:40:31.250

that money. I speak on behalf of every American who relies upon the brass plaque on his broker's

0:40:31.620,0:40:38.620

desk, SIPC. We are told when we invest that every account is insured up to \$500,000 and

0:40:43.120,0:40:50.120

yet, SIPC has taken the position in the Madoff case that the law doesn't apply to it.

0:40:51.070,0:40:56.430

If I had to grade the SEC's performance with respect to its essential function of

0:40:56.430,0:41:03.430

protecting investors with respect to the Madoff case, I would give the SEC and "F." The

0:41:03.770,0:41:09.390

SEC, instead of enforcing the law against SIPC, which it is charged by Congress with

0:41:09.390,0:41:16.390

the obligation to do, instead of enforcing

the law, we now know that in January 2009, Pg 25 of 73

0:41:17.470,0:41:24.130
the SEC agreed with SIPC that for the first time in its history, it would not pay SIPC

0:41:24.130,0:41:31.130
insurance to each Madoff victim based upon the investor's last statement.

0:41:32.100,0:41:38.270
SIPC is an insurance entity established by Congress which has the power to assess the

0:41:38.270,0:41:45.120
Wall Street firms who raised the funds to protect investors. The statute doesn't give

0:41:45.120,0:41:52.120
SIPC the right to define how it is going to allow a claim. The statute mandates that a

0:41:52.240,0:41:59.240
claim is based upon the customer's last statement. Yet, the SEC joined in SIPC's

0:41:59.930,0:42:01.540
violation of the statute.

0:42:01.540,0:42:08.540
This is not just my opinion, this is the opinion of Chairman Garrett who has proposed H.R.

0:42:10.590,0:42:17.320
757 and in proposing H.R. 757, which is simply a clarification of the law, one could view

0:42:17.320,0:42:24.320
H.R. 757 as a statement to the SEC, you cannot avoid the law and SIPC cannot avoid the law.

0:42:27.870,0:42:33.750
Mr. Garrett made a statement when he introduced this bill that SIPC has violated the law and

0:42:33.750,0:42:38.140
the trustee in the Madoff case has violated the law.

0:42:38.140,0:42:45.140
If you recall, in 1970 when SIPC was enacted, investors were encouraged to relinquish the

0:42:45.550,0:42:52.550
protection of having certificated securities. That was something that Wall Street wanted.

0:42:53.160,0:43:00.160
In exchange for relinquishment of that protection, investors were promised SIPC insurance. SIPC

0:43:01.280,0:43:08.280
insurance was raised to \$500,000 in 1978; it was never raised thereafter.

0:43:09.120,0:43:14.090
In the Madoff case, SIPC decided that was going to be too expensive for its Wall Street

0:43:14.090,0:43:21.090
members and so it was going to try to come with an entirely new basis for insuring accounts.

0:43:21.760,0:43:26.760
For the first time in SIPC's history, it decided it didn't insure the balance on

0:43:26.760,0:43:32.190
the last statement, it only insured the net investment over the life of the account which

0:43:32.190,0:43:37.150 Pg 26 of 73
might have been 20 years, 30 years, 40 years.

0:43:37.150,0:43:43.460

There is no evidence that any investor in today's stock market has or what he owns

0:43:43.460,0:43:48.550

other than the statements he receives from his broker. We don't have the luxury of

0:43:48.550,0:43:55.080

going back to certificated securities. The Internal Revenue Service relies upon those

0:43:55.080,0:43:59.680

statements, every investor relies upon those statements for planning their retirement,

0:43:59.680,0:44:06.680

for their estate plans for their children.

There is no basis in law for what the SEC

0:44:06.960,0:44:08.830

did in this case.

0:44:08.830,0:44:15.490

This is not a question of insufficient funding for the SEC. This is a question of doing its

0:44:15.490,0:44:19.280

mission which is to protect the investor.

0:44:19.280,0:44:24.230

I am not here to opine on whether or not Mr. Becker had a conflict of interest. I don't

0:44:24.230,0:44:31.180

think there can be any doubt about it. Whether he advocated the constant dollar adjustment,

0:44:31.180,0:44:37.850

which obviously reduced his own exposure, or whether he said to the SEC when he came

0:44:37.850,0:44:44.470

onboard in February 2009, you have made an illegal agreement with SIPC which would have

0:44:44.470,0:44:51.250

worked to his advantage, his judgment was clouded because everyone in the SEC forgot

0:44:51.250,0:44:53.090

the law.

0:44:53.090,0:44:58.080

There is one way to remedy this and to restore confidence in the capital markets for the

0:44:58.080,0:45:03.570

average American. That is to enact H.R. 757.

0:45:03.570,0:45:05.500

Thank you.

0:45:05.500,0:45:11.090

[Mr. McHenry] Thank you for your testimony. I thank the panel for its testimony. With

0:45:11.090,0:45:17.200

that, we will begin questioning on our side by Dr. Gosar of Arizona. He is recognized

0:45:17.200,0:45:17.800

for five minutes.

0:45:17.800,0:45:22.790

[Mr. Gosar] Chairman Schapiro, when David Becker, your brand new General Counsel, first

came to you in February 2009 and said, my mother had an account with Bernie Madoff,

0:45:28.410,0:45:32.230

why didn't you ask him any questions about it? Why didn't you even ask simple questions

0:45:32.230,0:45:33.230

like, how much money?

0:45:33.230,0:45:39.290

[Ms. Schapiro] Congressman, to the best of my recollection, and just so I can be clear,

0:45:39.290,0:45:43.560

I haven't looked at any emails or whether there might be any contemporaneous notes or

0:45:43.560,0:45:47.770

anything like that in this period of time, so I am recalling back because our Inspector

0:45:47.770,0:45:50.850

General is looking at all that, so I am recalling two years ago.

0:45:50.850,0:45:56.230

The best of my recollection was that Mr. Becker told me that his mother, who had passed away

0:45:56.230,0:46:03.230

years ago, had an account at Madoff. Because the account was closed years before, I did

0:46:05.090,0:46:09.550

not think that the account of a long deceased relative would raise an issue of a conflict

0:46:09.550,0:46:12.730

of interest in Mr. Becker's work.

0:46:12.730,0:46:17.780

I did expect that he would go to the Ethics Counsel, an experienced government official,

0:46:17.780,0:46:23.510

a government lawyer who served under three Chairmen at the SEC, and we use our Ethics

0:46:23.510,0:46:28.500

Counsel all the time for their advice. I expected him to run it by the Ethics Counsel and to

0:46:28.500,0:46:35.100

follow their advice and that is the way it went forward.

0:46:35.100,0:46:41.490

[Mr. Gosar] It seems that if the same situation existed in a publicly trade company that you

0:46:41.490,0:46:47.390

were investigating, would you have such a cavalier approach to that?

0:46:47.390,0:46:53.460

[Ms. Schapiro] It is hard for me to imagine this situation. These are the government ethics

0:46:53.460,0:46:53.710

rules.

0:46:53.520,0:46:56.010

[Mr. Gosar] An ethics rule nonetheless.

0:46:56.010,0:47:01.560

[Ms. Schapiro] It is very hard to answer in the abstract. It would depend on the rule.

0:47:01.560,0:47:07.150

[Mr. Gosar] It just seems there is a very Pg 28 of 73 different aspect that what is good in the

0:47:07.150,0:47:11.180
private sector and publicly trade situations
is not going well for the government.

0:47:11.180,0:47:17.870
Let us go to my next question. Ms. Chaitman,
do you believe the account valuation method

0:47:17.870,0:47:22.090
that David Becker recommended to the Commission
as its attorney would have befitting his personal

0:47:22.090,0:47:22.970
financial interest?

0:47:22.970,0:47:28.750
[Ms. Chaitman] There is no question that the
constant dollar approach, which apparently

0:47:28.750,0:47:34.800
Mr. Becker invented, would benefit him personally
and reduce his clawback exposure, but the

0:47:34.800,0:47:40.030
more significant problem with the conflict
of interest Mr. Becker had is that it clouded

0:47:40.030,0:47:46.830
his judgment. The law is absolutely clear
that every investor is entitled to SIPC insurance

0:47:46.830,0:47:53.450
based on his last statement. Mr. Becker had
an obligation, as General Counsel of the SEC,

0:47:53.450,0:47:58.730
to make sure that the SEC complied with the
law and enforced it against SIPC. That is

0:47:58.730,0:48:02.790
the great failure which has caused devastation
to all of my clients.

0:48:02.790,0:48:09.790
[Mr. Gosar] Chairman Schapiro, your agency's
Inspector General compiled a 457-page report

0:48:13.180,0:48:19.990
about the SEC's failure to uncover Madoff's
ponzi scheme. That report devotes two sections

0:48:19.990,0:48:26.110
out of 11 to describing in great detail every
possible connection between SEC employees

0:48:26.110,0:48:27.270
and Madoff.

0:48:27.270,0:48:31.530
Do you think that your General Counsel's
receiving funds from a Madoff account would

0:48:31.530,0:48:35.110
have been appropriate material, the Inspector
General or not?

0:48:35.110,0:48:39.790
[Ms. Schapiro] That would be a much better
question for the Inspector General. I have

0:48:39.790,0:48:44.940
a pretty high level of confidence that he
did quite a thorough report on the agency's

0:48:44.940,0:48:46.450
failures with respect to Madoff.

0:48:46.450,0:48:53.450

[Mr. Gosar] The Inspector General's Madoff Pg 29 of 73 report mentions on page 382, that two family

0:48:53.630,0:48:59.790

members of an employee in the Office of Internet Enforcement invested \$1.5 million and \$500,000

0:48:59.790,0:49:04.210

respectively with Madoff. The Inspector General found it necessary to make sure that this

0:49:04.210,0:49:07.690

employee had no involvement in any Madoff examination.

0:49:07.690,0:49:12.550

Do you think that the Inspector General would have been interested in a similar situation

0:49:12.550,0:49:17.370

involving your chief lawyer, a senior SEC official who served as General Counsel from

0:49:17.370,0:49:22.350

2000 to 2002 while the SEC was ignoring whistleblower complaints about Madoff?

0:49:22.350,0:49:27.700

[Ms. Schapiro] I can't predict. I can imagine that he might have been and of course he is

0:49:27.700,0:49:32.000

looking at all of these issues now. I expect that he will thoroughly explore that.

0:49:32.000,0:49:39.000

[Mr. Gosar] I understand that you inherited a horrific problem but it always starts with

0:49:39.210,0:49:46.210

top down. Private sector, businesses always look at accountability within the hierarchy.

0:49:46.560,0:49:53.350

It seems like we have a two-edge sword here that we should have demanded better accountability.

0:49:53.350,0:49:53.900

Would you agree?

0:49:53.900,0:49:58.660

[Ms. Schapiro] Congressman, I would agree that from where I sit now and understanding

0:49:58.660,0:50:03.930

all the things that I understand now that I didn't understand in 2009, having arrived

0:50:03.930,0:50:10.930

at the SEC and discovered that I had an agency in absolute ruin in some regards on my hands

0:50:11.350,0:50:18.350

to manage and not knowing obviously all the steps that would be taken by the Trustee or

0:50:18.520,0:50:25.480

the decisions the Commission would make down the road, but knowing those things now, I

0:50:25.480,0:50:27.600

wish that Mr. Becker had recused himself, absolutely.

0:50:27.600,0:50:29.740

[Mr. McHenry] The gentleman's time has expired.

0:50:29.740,0:50:32.710

The gentleman from Illinois, Mr. Quigley, is recognized for five minutes.

0:50:32.710,0:50:35.350

*Mr. Quigley. Thank you, Mr. Chairman.

0:50:35.350,0:50:41.620

Madam Chairman, the New York Times reported
on March 5 of this year that the SEC has declined

0:50:41.620,0:50:46.990

to enforce the requirement from Dodd-Frank
that would make rating agencies subject to

0:50:46.990,0:50:52.670

expert liability under the securities law.
This would make rating agencies liable for

0:50:52.670,0:50:57.780

faulty ratings. Could you comment on the timeline
for implementing this measure?

0:50:57.780,0:51:04.000

[Ms. Schapiro] Yes, I would be happy to. The
way the rule works is that if a rating is

0:51:04.000,0:51:09.910

included in a registration statement for securities,
then the rating agency must consent to having

0:51:09.910,0:51:13.040

liability. That is the Dodd-Frank requirement.

0:51:13.040,0:51:18.640

We had preexisting SEC rules that require
for AXA-backed securities registration statements,

0:51:18.640,0:51:24.760

that if a rating was used to sell the securities,
the rating needed to be included in the registration

0:51:24.760,0:51:29.270

statement. Rating agencies have absolutely,
unequivocally -- at least the ones that are

0:51:29.270,0:51:35.700

in existence now -- refused to consent. That
made public offerings of AXA-backed securities

0:51:35.700,0:51:40.470

impossible because they couldn't get the
consent of the rating agencies to include

0:51:40.470,0:51:43.980

the ratings, but they used the ratings to
sell the securities.

0:51:43.980,0:51:50.520

We temporarily set aside our rule, our requirement
that the AXA backed issuers disclose the ratings

0:51:50.520,0:51:54.920

in the registration statements because we
didn't want to be holding up all public

0:51:54.920,0:51:59.540

offerings of AXA-backed securities and pushing
them into the private markets which we felt

0:51:59.540,0:52:04.520

were not as good for investors.

0:52:04.520,0:52:10.450

Right now, our staff is working through reconsideration
of our disclosure requirements. I believe

0:52:10.450,0:52:14.780

they will recommend that we eliminate our
preexisting requirement for including the

0:52:14.780,0:52:18.120

ratings and therefore, the liability provisions
can go forward.

0:52:18.120,0:52:23.180

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We are also hopeful that some of the newer rating agencies that have indicated an interest

0:52:23.180,0:52:28.290

in becoming registered with us will actually be willing to consent, which is I think how

0:52:28.290,0:52:29.610

Congress hoped the law would work.

0:52:29.610,0:52:32.280

[Mr. Quigley] Can you guess on the timeframe for that?

0:52:32.280,0:52:36.550

[Ms. Schapiro] I can't but I would be more than happy to. I would say over the next couple

0:52:36.550,0:52:39.960

of months, but I would be happy to get you a more definitive answer right away.

0:52:39.960,0:52:45.410

[Mr. Quigley] Thank you. You talked about the agency that you inherited and you talked

0:52:45.410,0:52:52.410

to a certain extent about the reforms necessary and those you have implemented. As to Mr.

0:52:52.480,0:52:58.490

Katz's point, whether or not more assets, and I think you need the assets to do your

0:52:58.490,0:53:05.490

job, help more than the need for in a sense restructuring, reforming and reinventing yourself.

0:53:05.780,0:53:10.960

Are you looking at the agency from that perspective and the broader picture? If you were to start

0:53:10.960,0:53:12.710

over, what would you do and how would you do it?

0:53:12.710,0:53:17.190

[Ms. Schapiro] Absolutely. I actually would do again many of the things we have already

0:53:17.190,0:53:22.140

done. This has been an agency that has been sort of taken upside down and shaken pretty

0:53:22.140,0:53:27.440

hard over the last two years -- new leadership across the board in every major office and

0:53:27.440,0:53:32.150

division, a new Chief Operating Officer, a new Chief Ethics Counsel, our first ever Chief

0:53:32.150,0:53:33.250

Compliance Officer.

0:53:33.250,0:53:38.370

We also restructured our Enforcement Division and put people into specialized groups where

0:53:38.370,0:53:43.300

they could get deep expertise to bring enforcement cases more quickly in particular areas like

0:53:43.300,0:53:46.790

structured products or the Foreign Corrupt Practices Act or insider trading.

0:53:46.790,0:53:52.330

We have also restructured our examination program, both of those, enforcement and examination,

0:53:52.330,0:53:57.980

largely in response to the failures that were so vividly demonstrated in the Inspector General's

0:53:57.980,0:53:59.350
report on Madoff.

0:53:59.350,0:54:05.610

We have also brought new technology, which is going to be critical to us. We have too

0:54:05.610,0:54:08.920

many people doing low value work because we don't have the technology.

0:54:08.920,0:54:10.790

[Mr. Quigley] What do you mean low value work?

0:54:10.790,0:54:14.790

[Ms. Schapiro] For example, when we bring enforcement cases, we bring in massive amounts

0:54:14.790,0:54:21.530

of electronic data so that we can look at trading records or we can look at email transmissions

0:54:21.530,0:54:24.490

between parties who might be sharing non-public information.

0:54:24.490,0:54:31.110

We need to be able to use analytics to find the important information and all of that,

0:54:31.110,0:54:37.150

not have people plowing through all that information. When the markets fell so dramatically on May

0:54:37.150,0:54:41.910

6, it took us five months to reconstruct trading data because we don't have the capacity

0:54:41.910,0:54:42.740

in the SEC.

0:54:42.740,0:54:47.720

[Mr. Quigley] That was the final question we have limited time. Are you a technological

0:54:47.720,0:54:50.200

match for those that you are regulating?

0:54:50.200,0:54:54.320

[Ms. Schapiro] Not at the moment, we aren't. We have a phenomenal new Chief Information

0:54:54.320,0:55:00.140

Officer who is making real progress, I think, but we are a long way from the people that

0:55:00.140,0:55:05.490

we are regulating in terms of our technical capability, but I think we can get there.

0:55:05.490,0:55:08.480

I think we can put up a good fight anyway.

0:55:08.480,0:55:10.500

[Mr. Quigley] Thank you. I yield back.

0:55:10.500,0:55:16.230

[Mr. McHenry] I thank the gentleman. I now recognize the Vice Chair of the TARP, Financial

0:55:16.230,0:55:20.020

Services and Bailouts Subcommittee, Mr. Guinta of New Hampshire, for five minutes.

0:55:20.020,0:55:22.170

[Mr. Guinta] Thank you very much, Mr. Chairman.

0:55:22.170,0:55:27.410

Mr. Katz, thank you and thank all of the witnesses
for being here today. wanted to direct my

0:55:27.410,0:55:28.990

first question to you, sir.

0:55:28.990,0:55:33.750

In your testimony, you talked about the size,
structure and complexity of the U.S. capital

0:55:33.750,0:55:38.700

markets and financial companies that have
grown substantially in the past 30 years.

0:55:38.700,0:55:45.700

I think your position is that you are comparing
the SEC over that same period of time and

0:55:46.470,0:55:51.740

the fact that it has not grown, changed or
modified substantially. I wanted to get a

0:55:51.740,0:55:54.550

little clarification on that first, if you
would.

0:55:54.550,0:56:01.550

[Mr. Katz] Obviously I think everyone would
agree that the capital markets of today are

0:56:02.570,0:56:07.110

exponentially greater, but my point was more
directed to the way the SEC is structured.

0:56:07.110,0:56:11.440

It is not just a question of size; it is a
question of a structure that corresponds to

0:56:11.440,0:56:16.750

the entities you are regulating. The point
I was making is that in the early 1970s when

0:56:16.750,0:56:22.700

basically the current organizational structure
of the SEC was last reformed, you had market

0:56:22.700,0:56:29.540

regulation that focused on stock exchanges
and broke dealers. You had a Division of Investment

0:56:29.540,0:56:35.380

Management Regulation which focused on mutual
funds and investment advisors. They were two

0:56:35.380,0:56:40.820

very separate components of the industry and
there really was very little overlap.

0:56:40.820,0:56:47.820

That no longer exists. Because of consolidation
in the industry and the blending of the roles,

0:56:50.580,0:56:55.460

the fundamental distinction between a stock
broker who is a commission-based seller of

0:56:55.460,0:57:02.460

securities and an investment advisor, who
is an under management advisor on a comprehensive

0:57:04.070,0:57:07.670

portfolio, is a historical artifact. It doesn't
exist.

0:57:07.670,0:57:14.670

Because you have two divisions upon two different
laws, according to a model that no longer

0:57:15.040,0:57:20.760

exists, you get these anomalies. The fight Pg 34 of 73 over fiduciary duty differential was embedded

0:57:20.760,0:57:26.110
in the laws but more importantly, you had
two different divisions who had different

0:57:26.110,0:57:31.750
ways of thinking about it and neither of them
wanted to compromise. They both wanted to

0:57:31.750,0:57:33.570
maintain their piece of it.

0:57:33.570,0:57:38.270
[Mr. Guintal] Does that speak a little bit
to the silo effect that you have been referring

0:57:38.270,0:57:38.760
to?

0:57:38.760,0:57:45.760
[Mr. Katz] Absolutely. I used to joke that
the silos at the SEC were so real that in

0:57:46.270,0:57:51.020
fact, that they had locked doors and that
because all the paper in the agency used to

0:57:51.020,0:57:54.340
have to come through my office, I actually
had a skeleton key that occasionally allowed

0:57:54.340,0:58:01.340
me to unlock each of the silo doors and get
inside. Most people don't. Turf is a real

0:58:02.780,0:58:07.610
issue in any organization, no matter what
the size. It is compounded because remember

0:58:07.610,0:58:11.620
you have different securities laws that were
written at different points of time for different

0:58:11.620,0:58:18.620
segments of the industry. Each division sort
of jealousy guards the law that it controls.

0:58:19.210,0:58:20.150
The market has changed.

0:58:20.150,0:58:26.730
[Mr. Guintal] I listened to what Chairman Schapiro
mentioned in her earlier comments about some

0:58:26.730,0:58:33.360
of the improvements, modifications and changes
that she has made and they sound laudable

0:58:33.360,0:58:40.010
and responsible. That being said, I wonder
what type of congressional action may or may

0:58:40.010,0:58:47.010
not be necessary given the systemic problem
that we have seen within the SEC. I don't

0:58:47.740,0:58:54.510
want to get into the specifics, but the things
we have been talking about here. We have to

0:58:54.510,0:58:59.630
prevent these from happening again. People
in our Nation need to have confidence, not

0:58:59.630,0:59:06.480
just in the SEC, but in the markets as well.
I wonder what you could say about the type

0:59:06.480,0:59:09.610

of intervention you feel Congress should be Pg 35 of 73
considering?

0:59:09.610,0:59:16.400

[Mr. Katz] That is a very difficult question
for me to answer. The reason is I spent virtually

0:59:16.400,0:59:23.240

my entire career at the SEC and I think it
is very different for Congress to micromanage

0:59:23.240,0:59:29.050

the internal organization and operations of
a government agency. You can set policy, you

0:59:29.050,0:59:34.920

can give direction, but I think it is dangerous
when Congress tells the agency this is how

0:59:34.920,0:59:41.920

you get it done. I think the agency really
has to take this responsibility on. Chairman

0:59:42.410,0:59:48.080

Schapiro has brought in an entirely new team
of senior people. I don't know most of them.

0:59:48.080,0:59:49.800

They seem very competent.

0:59:49.800,0:59:56.800

My hesitation is this. If you rely exclusively
on a team of people coming in to effect change,

0:59:56.810,1:00:01.800

when those people walk out the door, the change
walks out with them. You need to change the

1:00:01.800,1:00:08.010

structure, you need to change the culture
and most importantly, you need the agency

1:00:08.010,1:00:12.270

to define what it is it is trying to do and
how do you measure whether it has gotten it

1:00:12.270,1:00:15.540

done. You need that discipline, but that is
for the agency to do.

1:00:15.540,1:00:16.640

[Mr. Guinta] Thank you, sir.

1:00:16.640,1:00:21.310

Chairman Schapiro, I only have a few seconds
left, but what assurance can you give us that

1:00:21.310,1:00:26.270

new management team is effectively managing
and maintaining the necessary changes?

1:00:26.270,1:00:30.210

[Ms. Schapiro] I have to say I think change
starts with leadership absolutely and having

1:00:30.210,1:00:34.450

a whole new leadership team makes an enormous
difference. They are very committed to working

1:00:34.450,1:00:38.880

together and institutionalizing cooperation
and collaboration among all of the divisions.

1:00:38.880,1:00:43.870

For example, we now have the College of Regulators
for the largest financial institutions. It

1:00:43.870,1:00:47.420

is no longer just the Trading and Markets
Division that looks at them, it is no longer

1:00:47.420,1:00:53.120

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just the examination group. There is a group of people drawn from all over the agency who

1:00:53.120,1:00:58.000

could have potential interest in the health of that financial institution who meet regularly

1:00:58.000,1:01:03.930

to talk about what is going on in that company, to look at the financials, to meet with the

1:01:03.930,1:01:08.010

staff of that financial institution. So the College of Regulators is just one example.

1:01:08.010,1:01:13.240

We have task forces across the agency. We are merging, in some of our offices and will

1:01:13.240,1:01:17.470

eventually in all of them, our examination programs for investment advisors and broker

1:01:17.470,1:01:19.080

dealers which Mr. Katz mentioned.

1:01:19.080,1:01:25.900

Finally, I should say that we have just commissioned, and I believe it is going to be released today,

1:01:25.900,1:01:30.710

Dodd-Frank required us to hire an independent consultant to do a very in-depth study of

1:01:30.710,1:01:35.830

the SEC's organizational structure. That will be released today. I fully expect that

1:01:35.830,1:01:40.710

there will be some really helpful ideas there for us to further improve how we operate.

1:01:40.710,1:01:43.900

[Mr. McHenry] The gentleman's time has expired. With that, I recognize the Ranking Member,

1:01:43.900,1:01:44.900

Mr. Towns.

1:01:44.900,1:01:48.820

[Mr. Towns] Thank you very much, Mr. Chairman.

1:01:48.820,1:01:55.350

Let me thank all of you for being here. I really appreciate you taking the time to come.

1:01:55.350,1:02:02.350

Chairman Schapiro, the SEC plays a critical role in protecting investors and ensuring

1:02:02.450,1:02:09.450

that our financial markets operate effectively. You have stated that freezing the SEC budget

1:02:11.710,1:02:18.710

impedes the agency's ability to meet its mission, which is to protect investors, to

1:02:19.960,1:02:26.940

maintain fair, orderly and efficient markets, and facilitate capital information. Can you

1:02:26.940,1:02:32.290

put that in concrete terms for us?

1:02:32.290,1:02:39.290

If the SEC does not have the budget to properly oversee capital markets, how would effect

1:02:40.910,1:02:41.910

your staffing? Pg 37 of 73

1:02:41.910,1:02:47.100

[Ms. Schapiro] Yes, sir, I would be happy to. I think the two things that are most severely

1:02:47.100,1:02:52.940

impacted by a limited budget at the SEC are capability to hire the new kinds of talent

1:02:52.940,1:02:58.340

and expertise we need, economists, people who worked in hedge funds on trading desks,

1:02:58.340,1:03:03.080

financial analysts, the new expertise that will help us keep up with what is going on

1:03:03.080,1:03:03.900

in the marketplace.

1:03:03.900,1:03:10.900

The second is the fact that it will slow down and really hurt our efforts at reforming our

1:03:10.990,1:03:16.420

technology and bringing it up to speed and giving us the capacity to do the things we

1:03:16.420,1:03:21.210

need to do in order to keep up with Wall Street. I know we will never meet their budgets. I

1:03:21.210,1:03:24.470

understand that. I have no expectation and don't believe the American public should

1:03:24.470,1:03:29.920

pay for us to have a \$3 billion a year technology budget, but we have to do much better than

1:03:29.920,1:03:31.610

we have been able to do.

1:03:31.610,1:03:36.490

I think those are the two primary things that are really impacted. It plays out in lots

1:03:36.490,1:03:42.460

of other ways. When we don't have a sufficient travel budget, examiners can't travel to

1:03:42.460,1:03:48.220

go into that mutual fund where most Americans hold their investing wealth, and examine the

1:03:48.220,1:03:53.810

mutual fund's books and records. They can't go to the investment advisor or to the broker

1:03:53.810,1:03:54.670

dealer.

1:03:54.670,1:04:01.260

In little ways, the lack of resources plays out but the real fundamental ways are bringing

1:04:01.260,1:04:07.140

in those people that we need to really reform and transform the agency so people know that

1:04:07.140,1:04:12.190

we have at least a fighting chance at staying on top of what is happening on Wall Street

1:04:12.190,1:04:18.140

so we can also respond when the emergencies come along as we saw on May 6 when the market

1:04:18.140,1:04:24.190

absolutely fell apart, scared people very

badly in the retail investing public and in Pg 38 of 73

1:04:24.190,1:04:28.910

the institutional investing public as well.
We need the capability to respond to those

1:04:28.910,1:04:30.090

things very, very quickly.

1:04:30.090,1:04:35.470

[Mr. Towns] What about the flexibility? Do
you have that? For instance, if there is a

1:04:35.470,1:04:42.470

crisis situation and you need a specific type
of person and in order to get that person,

1:04:43.140,1:04:47.660

you might need additional resources to be
able to track who you need to do the job at

1:04:47.660,1:04:50.970

that particular time, do you have that kind
of flexibility?

1:04:50.970,1:04:55.250

[Ms. Schapiro] We have had some flexibility
over the last two years because Congress has

1:04:55.250,1:05:01.400

been generous in our budget, but if we continue
with the CR level or are cut, the answer to

1:05:01.400,1:05:08.400

that is no. May 6 required us to go out and
bring in experts to help us analyze and go

1:05:09.950,1:05:15.120

through all the trading data so we could reconstruct
for the public to see what was happening every

1:05:15.120,1:05:22.120

second in the marketplace when the Dow dropped
500 points in a matter of a few minutes.

1:05:24.090,1:05:30.610

Responding to emergencies is one of the things
I do worry about. That is where we lose flexibility

1:05:30.610,1:05:34.020

if we don't have a sufficient appropriation.

1:05:34.020,1:05:38.110

[Mr. Towns] Thank you, very much. On that
note, I yield back.

1:05:38.110,1:05:42.790

[Mr. McHenry] Thank you. With that, I recognize
Mr. Mack from Florida for five minutes.

1:05:42.790,1:05:47.920

[Mr. Mack] Thank you, Mr. Chairman. I also
want to thank the panel for being here today

1:05:47.920,1:05:54.920

to give us an opportunity to get your insights
and to ask a few questions on a very serious

1:05:55.550,1:05:56.780

topic.

1:05:56.780,1:06:03.780

I would like to start with Chairman Schapiro,
if I might. Do you feel as Chair of the agency

1:06:03.980,1:06:09.480

that ultimately it is your responsibility
to ensure that all of the employees are acting

1:06:09.480,1:06:13.050

in accordance with SEC employee conduct standards?

1:06:13.050,1:06:20.050

[Ms. Schapiro] I have responsibility for the agency in that sense. I cannot tell you that

1:06:20.770,1:06:26.560

with 3,800 employees, I can take individual responsibility for each and ever one to ensure

1:06:26.560,1:06:30.190

that they are following the requirements the way they should be.

1:06:30.190,1:06:37.190

[Mr. Mack] Ultimately, it is your responsibility as the Chair of the SEC?

1:06:37.220,1:06:40.710

[Ms. Schapiro] Ultimately, I am responsible for the agency's conduct.

1:06:40.710,1:06:46.510

[Mr. Mack] If I could direct your attention to slide number four, Chairman Schapiro, are

1:06:46.510,1:06:50.280

you familiar with the rule that is being presented on the screen?

1:06:50.280,1:06:50.530

[Ms. Schapiro] Yes.

1:06:50.470,1:06:57.470

[Mr. Mack] After reading through my material and hearing your testimony, it seems to me

1:06:59.760,1:07:06.460

that you weren't completely knowledgeable of this rule at the time you hired David Becker.

1:07:06.460,1:07:13.460

Please allow me to read it so everyone in the room can understand the entire rule.

1:07:13.710,1:07:18.700

"The Securities and Exchange Commission has been entrusted by Congress with the protection

1:07:18.700,1:07:25.700

of the public interest in a highly significant area of our national economy. In view of the

1:07:26.800,1:07:33.160

effect which Commission action frequently has on the general public, it is important

1:07:33.160,1:07:39.480

that members, employees and special government employees maintain unusually high standards

1:07:39.480,1:07:46.480

of honesty, integrity, impartiality and conduct. They must be constantly aware of the need

1:07:47.520,1:07:54.520

to avoid situations which might result either in actual or apparent misconduct or conflicts

1:07:54.990,1:08:01.990

of interest and to conduct themselves in the official relationships in a manner which commands

1:08:02.250,1:08:06.850

the respect and confidence of their fellow citizens."

1:08:06.850,1:08:11.790

Chairman Schapiro, were you familiar with this rule at the time that you received David

1:08:11.790,1:08:13.270

Becker as your General Counsel?

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1:08:13.270,1:08:18.250

[Ms. Schapiro] I can't tell you whether I had read it. I have been in and out of government

1:08:18.250,1:08:20.929

most of my career, so I am generally aware of the ethics rules.

1:08:20.929,1:08:27.929

[Mr. Mack] I only have a little bit of time. A moment ago, you said you were familiar with

1:08:28.909,1:08:29.210

the rule.

1:08:29.210,1:08:36.210

[Ms. Schapiro] I am but you just asked me was I aware of it at the time that David Becker

1:08:37.049,1:08:41.460

arrived at the Commission. I am telling you I can't recall whether I had reread the

1:08:41.460,1:08:43.730

rule recently at that point or not.

1:08:43.730,1:08:47.799

[Mr. Mack] Throughout your time in the 1980s and 1990s, you were familiar with this rule?

1:08:47.799,1:08:52.690

[Ms. Schapiro] Yes, I am generally aware of the ethics rules and that it is each employee's

1:08:52.690,1:08:52.940

obligation.

1:08:52.690,1:08:56.420

[Mr. Mack] Regarding David Becker's work with the Madoff case, do you believe that

1:08:56.420,1:09:03.420

Mr. Becker was sufficiently aware of the need to avoid actual or apparent conflicts of interest?

1:09:04.509,1:09:11.509

[Ms. Schapiro] I want to be very careful. I believe he did what he thought was appropriate

1:09:13.170,1:09:17.499

and what was required of him, going to the Ethics Counsel and seeking advice, getting

1:09:17.499,1:09:22.699

that advice and following it. Do I wish now that he had been more sensitive to the potential

1:09:22.699,1:09:28.679

for this issue to raise an appearance of a conflict? Yes, I wish that had happened.

1:09:28.679,1:09:32.609

[Mr. Mack] A few more questions. Do you think that you were sufficiently aware of the need

1:09:32.609,1:09:35.249

to avoid actual or apparent conflicts of interest?

1:09:35.249,1:09:38.839

[Ms. Schapiro] On my part, yes. I believe I am.

1:09:38.839,1:09:45.259

[Mr. Mack] You said now a couple times, I think, that you wished Mr. Becker would have

1:09:45.259,1:09:52.259

recused himself. Is that because of the fallout or do you really believe he should have recused

1:09:52.650,1:09:52.900
himself?

1:09:52.650,1:09:59.650
[Ms. Schapiro] I believe, as I said, at the time from my perspective, a close account

1:10:01.320,1:10:06.739
from a long since deceased relative didn't appear to me to raise a conflict of interest,

1:10:06.739,1:10:12.130
but I believe now, knowing what we know now, not because of the fallout, though that is

1:10:12.130,1:10:17.199
very real, but because if we could connect the dots and look ahead and see what all the

1:10:17.199,1:10:21.530
steps would have been, yes, it would have been appropriate to have recused.

1:10:21.530,1:10:28.530
[Mr. Mack] Let me say this. Also earlier, you kind of referred to the budget as kind

1:10:30.579,1:10:37.539
of the reason why some of these mistakes happened. How much does it cost to follow that rule?

1:10:37.539,1:10:42.309
[Ms. Schapiro] That is a personal initiative. It doesn't really cost anything.

1:10:42.309,1:10:48.820
[Mr. Mack] So the argument about the budget as it pertains to this rule, doesn't hold

1:10:48.820,1:10:55.769
water? The argument about the budget in your opening statement that you talked about really

1:10:55.769,1:10:57.670
doesn't pertain to this rule?

1:10:57.670,1:11:02.329
[Ms. Schapiro] No, and I didn't mean to suggest in any way that it did.

1:11:02.329,1:11:02.860
[Mr. Mack] Thank you.

1:11:02.860,1:11:07.389
[Mr. McHenry] The gentleman's time has expired. With that, I recognize the Ranking Member

1:11:07.389,1:11:07.800
of the full committee.

1:11:07.800,1:11:12.570
[Mr. Cummings] I don't want that to be left hanging. I never heard you, and I heard all

1:11:12.570,1:11:17.789
of your testimony and I have read your testimony, Ms. Schapiro, you never made that allegation.

1:11:17.789,1:11:23.119
I want to make that clear. I haven't heard it. I think it is a very unfair statement.

1:11:23.119,1:11:30.119
Let me go on. Chairman Schapiro, I must tell you that when I was talking to my staff -- as

1:11:33.699,1:11:38.960
a matter of fact, when we were emailing back and forth at 4:00 a.m. this morning about

1:11:38.960,1:11:45.960

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this case, because it does trouble me to a degree with regard to the appearance of a

1:11:48.219,1:11:51.260
conflict of interest.1:11:51.260,1:11:58.260
I think when we hear what Ms. Chaitman had to say, that shows you why, and I am sure1:12:03.749,1:12:10.749
you see it, we have to make sure that we don't even have the appearance because what happens1:12:11.610,1:12:18.610
is that every decision made by Mr. Becker then becomes suspect. It is my favorite author,1:12:19.909,1:12:26.909
Covey who in the book, "The Speed of Trust," says that "Once trust is lost, everything1:12:27.760,1:12:34.760
moves more slowly." So I cannot begin to tell you how pleased I was when you walked1:12:35.860,1:12:42.860
in here today and said we will go beyond what may be required. That is so very, very important.1:12:44.499,1:12:50.400
In my office, I have five people that whenever there is an ethics question, they all have1:12:50.400,1:12:56.300
to agree and if one vetoes, it is out the door. Why? Because the public is looking over1:12:56.300,1:13:01.010
our shoulders, we want to do the right thing and we want to make sure that it is right.1:13:01.010,1:13:08.010
This has been a major wake up call, hasn't it. Here in this committee, it is so easy1:13:13.329,1:13:19.489
for us to get into a gotcha mode, but I must tell you, after I read about what you had1:13:19.489,1:13:24.989
done at the SEC since you have been there, and having sat on this committee and watched1:13:24.989,1:13:31.989
Mr. Cox and what he did with this organization and how it went down under him, to see you1:13:32.800,1:13:39.800
come and try to sweep up the mess, I must commend you.1:13:40.070,1:13:46.619
The sad part about it is that one of these little incidents basically can almost destroy1:13:46.619,1:13:49.630
that trust. Do you understand what I am saying?1:13:49.630,1:13:56.630
So I want you to commit to this committee, if you will. Tell me, if these incidents come1:13:59.920,1:14:06.920
up again, tell us the difference in how you might approach it. I understand what you did.1:14:07.480,1:14:14.179
A fellow comes to you, he tells you, years ago, I got an inheritance and he wants to

1:14:14.179,1:14:19.340

know about a conflict. You listened to it
for a while. You have 3,800 employees to deal

1:14:19.340,1:14:24.929

with, you hear him and then you say, you know
what, the expert on this is the ethics guy.

1:14:24.929,1:14:29.409

Make sure you check with him and he got an
opinion.

1:14:29.409,1:14:33.949

How would you deal with this differently now,
looking backwards?

1:14:33.949,1:14:37.429

[Ms. Schapiro] We have a new Ethics Counsel,
first of all, who is doing sort of a top to

1:14:37.429,1:14:42.840

bottom review of our program, but I think
I need to work with all of our employees and

1:14:42.840,1:14:48.050

communicate with all of our employees about
a heightened sensitivity to issues like this.

1:14:48.050,1:14:54.860

I have worked so hard in the last two years
to try to put this agency back on the right

1:14:54.860,1:14:59.800

path and to earn the trust of the public.
You are right, a small thing like this, not

1:14:59.800,1:15:04.860

so small thing like this, can really set us
back. It is not fair to 3,800 hardworking

1:15:04.860,1:15:05.269

employees.

1:15:05.269,1:15:11.420

It is just like when somebody mentioned in
their opening statement that employees had

1:15:11.420,1:15:18.420

viewed pornography at the SEC. It infuriates
me because most people there are working their

1:15:18.999,1:15:23.710

hearts out day and night to try to do the
right thing. It hurts the reputation of every

1:15:23.710,1:15:24.809

single one of us.

1:15:24.809,1:15:29.679

I have to work with our employees to make
sure that we increase their sensitivity to

1:15:29.679,1:15:36.110

issues like this. I think with our new Ethics
Counsel and their review of the program and

1:15:36.110,1:15:40.880

how it might be strengthened, we will get
some good advice. I think the Inspector General

1:15:40.880,1:15:44.139

is likely to have some recommendations that
will be very helpful too.

1:15:44.139,1:15:51.139

[Mr. Cummings] I read in your testimony where
you talked about technology and trying to

1:15:51.260,1:15:58.260

keep up with these ever changing transactions

and how complicated they have become. I want Pg 44 of 73

1:15:59.480,1:16:04.320

to make sure you have all the resources you
need to address this because so many of our

1:16:04.320,1:16:11.320

constituents on both sides lost a lot of money.
Like Mr. Crimmins said, they need confidence

1:16:11.809,1:16:14.789

to reenter this system of stocks.

1:16:14.789,1:16:16.630

[Ms. Schapiro] I agree.

1:16:16.630,1:16:18.280

[Mr. Cummings] Thank you.

1:16:18.280,1:16:23.860

[Mr. McHenry] I thank the Ranking Member.
With that, we yield for five minutes to Mr.

1:16:23.860,1:16:24.619

Ross of Florida.

1:16:24.619,1:16:26.510

[Mr. Ross] Thank you, Mr. Chairman.

1:16:26.510,1:16:30.360

As a kid, I always wanted to be a lawyer and
fortunately I found a law school that would

1:16:30.360,1:16:35.519

take me. I went to law school and I always
had a deep seated respect for the sanctity

1:16:35.519,1:16:42.159

of the law, so much so that I was gratified
that the American Bar Association and my state

1:16:42.159,1:16:46.489

bar association required not only a course
but an examination on the Code of Professional

1:16:46.489,1:16:47.300

Responsibility.

1:16:47.300,1:16:52.409

Ms. Schapiro, I understand that you too are
a lawyer and that even though you inherited

1:16:52.409,1:16:59.409

quite a mess at a time of great disarray at
the SEC, my question is as a lawyer, when

1:17:02.900,1:17:08.670

Mr. Becker came to you, did you not think
that a further investigation should be made?

1:17:08.670,1:17:15.360

As a lawyer, we do conflicts checks, we make
sure of that and it just seems to me that

1:17:15.360,1:17:22.360

if further inquiries had been made at that
time, this might have been avoided.

1:17:22.389,1:17:27.749

[Ms. Schapiro] I don't disagree with you
that if further inquiries had been made, this

1:17:27.749,1:17:33.420

might have been avoided. I can only say what
I said at the beginning, that when he raised

1:17:33.420,1:17:38.929

it with me, that he had a closed account,
I didn't know if it had been a net winner

1:17:38.929,1:17:43.969

account, a net loser account or anything else Pg 45 of 73 from a deceased relative, it didn't raise

1:17:43.969,1:17:45.749
for me a conflict of interest question.

1:17:45.749,1:17:52.749
[Mr. Ross] The fact that he asked for a waiver from his subordinate is indicative of a problem,

1:17:55.320,1:17:58.420
an inherent internal problem there from an ethical standpoint.

1:17:58.420,1:18:04.800
[Ms. Schapiro] I don't know that he asked for a waiver and I again, I have no access

1:18:04.800,1:18:11.699
to any contemporaneous documents of any sort.
He asked whether or not he had a conflict

1:18:11.699,1:18:14.469
and was advised that he did not have a conflict.

1:18:14.469,1:18:18.309
[Mr. Ross] Did you know who was advising him that there was no conflict?

1:18:18.309,1:18:22.400
[Ms. Schapiro] It was the Ethics Counsel of the SEC at that time who is no longer the

1:18:22.400,1:18:23.219
Ethics Counsel.

1:18:23.219,1:18:26.369
[Mr. Ross] As General Counsel, that would be under him, would it not?

1:18:26.369,1:18:28.449
[Ms. Schapiro] I believe that is the case in most agencies.

1:18:28.449,1:18:30.889
[Mr. Ross] Do you feel this would be avoided again in the future?

1:18:30.889,1:18:37.889
[Ms. Schapiro] I would love to say absolutely without a doubt, but it would be my very strong

1:18:39.349,1:18:45.489
hope that with a very strong new Ethics Counsel that we hired from the Treasury Department

1:18:45.489,1:18:51.550
with long government experience, with a revamping of our programs and with some additional education

1:18:51.550,1:18:55.619
and training for our people, I would hope and expect that we could avoid this.

1:18:55.619,1:18:58.809
[Mr. Ross] I think the American public needs that assurance that credibility is going to

1:18:58.809,1:18:59.639
be there.

1:18:59.639,1:19:05.360
Mr. Risinger, with regard to human resources, are your employees all part of the general

1:19:05.360,1:19:06.789
schedule in terms of compensation?

1:19:06.789,1:19:11.179
[Mr. Risinger] Congressman, actually we have a separate pay schedule that we received from

1:19:11.179,1:19:13.889

legislation of Congress back in 2001, 2002.

1:19:13.889,1:19:19.010

[Mr. Ross] Were you subject to the pay freeze that the President issued?

1:19:19.010,1:19:19.630

[Mr. Risinger] Yes, we are.

1:19:19.630,1:19:25.230

[Mr. Ross] That just really affected the cost of living increases, didn't it?

1:19:25.230,1:19:27.179

[Mr. Risinger] It does affect the cost of living increases.

1:19:27.179,1:19:30.219

[Mr. Ross] What about within pay grade or step increases? Did it affect that?

1:19:30.219,1:19:36.829

[Mr. Risinger] We have a merit pay process that is the equivalent of step increases for

1:19:36.829,1:19:40.119

the rest of the government, so that is technically affected by the pay freeze.

1:19:40.119,1:19:45.559

[Mr. Ross] In your disciplinary procedures, let me ask you this. What is the probationary

1:19:45.559,1:19:46.309

period for any employee?

1:19:46.309,1:19:47.889

[Mr. Risinger] It is generally a year.

1:19:47.889,1:19:54.659

[Mr. Ross] One year. After one year, if there is a disciplinary situation, is a presumption

1:19:54.659,1:20:01.429

in favor of the employee if they have been found in violation or alleged violation of

1:20:01.429,1:20:03.159

any personnel policies?

1:20:03.159,1:20:08.249

[Mr. Risinger] The Federal laws that we have to follow in terms of disciplining employees

1:20:08.249,1:20:11.729

set out a number of standards that we have to go through. There are actually 12 factors

1:20:11.729,1:20:16.690

that you have to look at when you are issuing discipline and one of them is a factor that

1:20:16.690,1:20:21.090

says, is this the level of discipline that is necessary to stop the behavior and not

1:20:21.090,1:20:26.710

more than that. So there is a presumption that you are taking a preventive or corrective

1:20:26.710,1:20:29.019

step, not necessarily a punitive step.

1:20:29.019,1:20:31.329

[Mr. Ross] These would have been the same procedures employed in those involved in the

1:20:31.329,1:20:32.210

viewing of pornography, correct?

1:20:32.210,1:20:33.030

[Mr. Risinger] That is correct.

1:20:33.030,1:20:36.900

[Mr. Ross] Only one person was fired as a result of that?

1:20:36.900,1:20:43.900

[Mr. Risinger] Of the cases we have had since 2005, 50 percent or 51 percent have either

1:20:45.130,1:20:51.309

resigned, retired or have proposed removals in place. We have had a number of suspensions

1:20:51.309,1:20:52.300

and reprimands as well.

1:20:52.300,1:20:56.070

[Mr. Ross] What is the attrition rate in your agency?

1:20:56.070,1:21:01.800

[Mr. Risinger] In the agency, in normal years, it is 7 to 8 percent. In the last couple of

1:21:01.800,1:21:06.309

years because of the economy, it has been in the 3-1/2 to 4 percent range.

1:21:06.309,1:21:09.030

[Mr. Ross] How does that compare with Federal agencies overall?

1:21:09.030,1:21:16.030

[Mr. Risinger] If we are talking just attrition in general, I think that is pretty equivalent

1:21:16.820,1:21:17.749

with other agencies.

1:21:17.749,1:21:24.749

[Mr. Ross] Last question. Ms. Chaitman, with regard to the Madoff situation specifically,

1:21:25.039,1:21:32.039

I saw where you put them on notice, what was going on. What action do you think would have

1:21:36.979,1:21:39.969

requested be done in order to avoid this conflict?

1:21:39.969,1:21:45.999

[Ms. Chaitman] Under the statute, Congress mandated that the SEC go into court and enforce

1:21:45.999,1:21:51.979

the law against SIPC. That is precisely what I asked Ms. Schapiro to do in my April 2,

1:21:51.979,1:21:58.469

2009 letter. In fact, when Ms. Schapiro testified on July 14 before the Subcommittee on Capital

1:21:58.469,1:22:04.460

Markets that she was going to do everything in her power to provide the maximum SIPC coverage

1:22:04.460,1:22:10.039

for all investors, I assumed that she was, in fact, going to follow my request. Now I

1:22:10.039,1:22:17.039

have learned that in January 2009, the SEC had already agreed with denial of SIPC insurance

1:22:17.999,1:22:19.400

to more than half of the victims.

1:22:19.400,1:22:22.190

[Mr. Ross] Thank you. I yield back.

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1:22:22.190,1:22:24.909

[Mr. McHenry] Thank you. Mr. Yarmoth of Kentucky
for five minutes.

1:22:24.909,1:22:26.619

[Mr. Yarmoth] Thank you, Mr. Chairman.

1:22:26.619,1:22:28.719

Thanks to all the witnesses for your testimony.

1:22:28.719,1:22:35.340

Over the last couple weeks I have been plowing
my way through the Financial Crisis Inquiry

1:22:35.340,1:22:41.239

Report which is anything but bedtime reading.
It will not put you to sleep, I guarantee

1:22:41.239,1:22:43.679

you that -- as a matter of fact, quite the
contrary.

1:22:43.679,1:22:50.090

I am sure, Chairman Schapiro, that you are
aware of what the report concluded, particularly

1:22:50.090,1:22:57.090

with regard to the SEC. I was interested in
an assessment of where you think you still

1:22:59.079,1:23:04.360

need to go to make sure that the failings
in the system as it concerned your agency

1:23:04.360,1:23:06.130

won't recur?

1:23:06.130,1:23:12.570

[Ms. Schapiro] As I have not looked at the
report recently, it obviously focused a lot

1:23:12.570,1:23:18.900

on the failures of the SEC's Consolidated
Supervision Program for the five largest investment

1:23:18.900,1:23:23.179

banks, all of which during the financial crisis
essentially disappeared or converted to bank

1:23:23.179,1:23:27.780

holding companies under the regulation of
the Fed. I think there are a lot of lessons.

1:23:27.780,1:23:34.469

I testified before the FCIC about the failures
of the agency with respect to that program.

1:23:34.469,1:23:38.749

There are a couple of things. One is that
it was a voluntary program, a voluntary regulatory

1:23:38.749,1:23:45.749

program which, in my view, doesn't work
very well. We had insufficient resources devoted

1:23:48.659,1:23:53.679

to the regulation of the five largest investment
banks. We didn't have people with the right

1:23:53.679,1:23:59.469

kind of expertise and I think in some ways
perhaps the most important thing is it required

1:23:59.469,1:24:03.079

a very different kind of supervision than
the SEC has traditionally done. It required

1:24:03.079,1:24:09.579

prudential supervision as opposed to the SEC's

going on-site, doing an examination, leaving Pg 49 of 73

1:24:09.579,1:24:11.530
and then perhaps bringing an enforcement case.

1:24:11.530,1:24:16.550
We didn't have the right mindset within
the agency I think for that kind of constant

1:24:16.550,1:24:22.949
prudential oversight approach that was really
necessary. There was a lack of management

1:24:22.949,1:24:29.949
focus, I think, with respect to the program.
There was a willingness to believe what our

1:24:30.059,1:24:34.030
people were being told by some of the leaders
in some of those financial institutions that

1:24:34.030,1:24:41.030
failed, a lack of skepticism which I think
really hurt us as well. That program was discontinued

1:24:41.559,1:24:44.099
by my predecessor, Chairman Cox.

1:24:44.099,1:24:51.099
[Mr. Yarmoth] With regard to the present situation,
because most people who observe the situation

1:24:53.409,1:25:00.409
now, agree I think that the situation in terms
of too big to fail, the largest investment

1:25:01.309,1:25:08.309
banks have, in fact, gotten larger and that
the wild west atmosphere in terms of risk

1:25:09.519,1:25:16.489
taking and so forth may not have been curtailed
at all. Is this a concern that you share?

1:25:16.489,1:25:22.199
Anyone else on the panel is welcome to respond
as well.

1:25:22.199,1:25:28.619
Looking at the Wall Street profit picture
and so forth, it looks like there hasn't

1:25:28.619,1:25:31.059
been a whole lot of change in behavior.

1:25:31.059,1:25:35.300
[Ms. Schapiro] I do think I can speak perhaps
most particularly to the over-the-counter

1:25:35.300,1:25:39.229
derivatives market where we have a very direct
responsibility, although much progress is

1:25:39.229,1:25:43.380
being made internationally with respect to
accounting standards and other prudential

1:25:43.380,1:25:43.960
measures.

1:25:43.960,1:25:50.960
Getting the over-the-counter derivatives market
into a transparent marketplace so that regulators

1:25:51.420,1:25:55.869
can understand the build up and concentration
of risk in financial institutions I think

1:25:55.869,1:26:00.679
is going to be a very, very important piece
of this. We are working through those rules

1:26:00.679,1:26:05.559
as is the Commodities Futures Trading Commission.
About half of them or so have been proposed

1:26:05.559,1:26:10.309
and I would expect while we are going to miss
for some of them the July 21 deadline, we

1:26:10.309,1:26:15.409
will get them over the finish line over the
course of the rest of this year. Then there

1:26:15.409,1:26:21.239
will be implementation and phasing periods
to go through. I think that will make a difference.

1:26:21.239,1:26:26.800
I think the work the FDIC is doing with the
Fed and others on living wills and plans for

1:26:26.800,1:26:31.479
financial institutions to wind down their
business appropriately will also make a very

1:26:31.479,1:26:33.979
big difference and then, of course, the capital
requirements.

1:26:33.979,1:26:40.979
[Mr. Yarmoth] A final question on that subject.
We talked about the problem potentially with

1:26:44.710,1:26:51.710
resources and the dangers that would ensue
if your budget was cut. Are you confident

1:26:53.110,1:26:57.690
that the legislative action that was taken,
Dodd-Frank, is sufficient or that there are

1:26:57.690,1:27:03.099
things that we yet need to do to make sure
that we don't have a situation recur as

1:27:03.099,1:27:03.940
it did two years ago?

1:27:03.940,1:27:09.869
[Ms. Schapiro] I think it makes large strides
towards filling the gaps that existed in the

1:27:09.869,1:27:15.519
regulatory regime. I will say that one of
my concerns about the budget is that we don't

1:27:15.519,1:27:21.300
have the capacity to operationalize the rules
that we are putting into place -- getting

1:27:21.300,1:27:26.690
swap markets participants registered and the
swap data analyzed and market surveillance

1:27:26.690,1:27:32.739
taken care of. Those are things that we will
have to put off, but I think it is incumbent

1:27:32.739,1:27:37.860
upon all of us as regulators who see these
markets close up to continue to tell Congress

1:27:37.860,1:27:42.719
where we think the issues are, where perhaps
Dodd-Frank wasn't the right approach and

1:27:42.719,1:27:44.070
where we think there are still gaps.

1:27:44.070,1:27:45.440
[Mr. Yarmoth] Thank you very much.

1:27:45.440,1:27:50.130

[Mr. McHenry] I thank the gentleman. With that, I yield five minutes to the Chairman

1:27:50.130,1:27:51.550

of the Full Committee, Mr. Issa.

1:27:51.550,1:27:55.400

[Mr. Issa] Thank you, Mr. Chairman.

1:27:55.400,1:28:00.829

Madam Chair, I just went over to the Business Roundtable and back, so I had the opportunity

1:28:00.829,1:28:07.829

to see about one-third of corporate America's profits in that room, almost all public companies,

1:28:09.110,1:28:16.110

probably all public companies except one, all regulated by the SEC. I was there talking

1:28:16.190,1:28:18.389

about impediments to job creation.

1:28:18.389,1:28:24.510

I am going to give you a little relief from the question de jour for a moment and ask,

1:28:24.510,1:28:30.949

Dodd-Frank is not perfect and it was not what you might call a low cost, low budget way

1:28:30.949,1:28:37.949

to get better performance with less cost. You have asked for 28 percent budget increase.

1:28:38.650,1:28:45.550

In fact, if you had only the budget increase necessary to do the work you were not doing

1:28:45.550,1:28:50.280

as well as you wanted to without all the new losses, what would that budget increase be

1:28:50.280,1:28:54.119

in your estimation? In other words, what would it cost to do it right without piling on new

1:28:54.119,1:28:59.320

regulations when there is no question there have been problems properly enforcing your

1:28:59.320,1:29:00.409

existing portfolio?

1:29:00.409,1:29:05.889

[Ms. Schapiro] Mr. Chairman, I would have to actually do the math but maybe this helps.

1:29:05.889,1:29:12.889

When we did our 2012 request, we viewed 40 percent of the positions and it was a total

1:29:13.820,1:29:19.929

of 780 positions or 584 full-time equivalents. We viewed 40 percent of those as going to

1:29:19.929,1:29:26.929

our ongoing programs -- that is 312 positions -- and 60 percent going to Dodd-Frank in limitations,

1:29:28.119,1:29:34.190

so hedge funds, oversight, over the counter derivatives, municipal advisors, whistleblower

1:29:34.190,1:29:37.619

programs, clearing agencies and so forth.

1:29:37.619,1:29:42.289

[Mr. Issa] To follow up on that quickly, the Pg 52 of 73 transparency elements that were asked for

1:29:42.289,1:29:49.289
and agreed on by SEC and other agencies never got into Dodd-Frank, so you don't have a

1:29:49.349,1:29:55.929
common mandate for reporting for transparency that had been worked out in the conference

1:29:55.929,1:29:59.099
and then didn't happen.

1:29:59.099,1:30:03.800
From this committee's standpoint we are interested, and you can answer for the record

1:30:03.800,1:30:08.349
if you are not completely ready today, how much savings could you get if, in fact, there

1:30:08.349,1:30:14.199
was transparent interoperability both inward and whenever possible, out to the public for

1:30:14.199,1:30:14.780
oversight?

1:30:14.780,1:30:18.559
[Ms. Schapiro] That is a great question and I would like to answer it for the record because

1:30:18.559,1:30:24.300
I do think it is important, particularly when you have a market like the over-the-counter

1:30:24.300,1:30:29.969
derivatives market with two regulators in the same space, that we try to be as consistent

1:30:29.969,1:30:34.320
as we possibly can and leverage each other as effectively as we can. If I can come back

1:30:34.320,1:30:35.400
to you on that, I would like to.

1:30:35.400,1:30:39.119
[Mr. Issa] I appreciate that and I want to give you an opportunity to be thoughtful because

1:30:39.119,1:30:43.150
that is a major initiative of this committee on a bipartisan basis in the last Congress

1:30:43.150,1:30:46.489
that didn't happen and we would like to renew it but would certainly take your input.

1:30:46.489,1:30:53.489
In the remaining two minutes, I do want to ask, Mr. Becker's conduct in retrospect

1:30:56.059,1:31:02.889
was not a good idea. It certainly has not led to confidence in the independence, transparency

1:31:02.889,1:31:09.400
and non-biased behavior of the SEC when we look through the tail light.

1:31:09.400,1:31:16.329
How can we know that the changes you are asking to be reviewed are going to clearly eliminate

1:31:16.329,1:31:19.590
anything like this in the future? Where do we get the confidence in that?

1:31:19.590,1:31:26.590

[Ms. Schapiro] Mr. Chairman, I think it is Pg 53 of 73
a fair question. You and I have had many conversations

1:31:27.300,1:31:33.170
and I try to be very transparent and up front.
We will obviously be public about what our

1:31:33.170,1:31:38.460
Inspector General finds and what recommendations
he makes, what our new Ethics Counsel finds

1:31:38.460,1:31:45.159
as she reviews our program and recommendations
she makes. We will be happy to come back and

1:31:45.159,1:31:49.699
talk to Congress about those findings and
those recommendations and see if we can develop

1:31:49.699,1:31:55.039
some metrics that would actually help us figure
out whether we are getting it right.

1:31:55.039,1:31:59.499
[Mr. Issa] Your Ethics Counsel served under
the General Counsel, a career position but

1:31:59.499,1:32:01.380
under the General Counsel, correct?

1:32:01.380,1:32:02.229
[Ms. Schapiro] Yes.

1:32:02.229,1:32:06.690
[Mr. Issa] Would you consider moving that
to be independent direct report so that there

1:32:06.690,1:32:13.460
would only be one person, a political appointee
like yourself, that would be between the public

1:32:13.460,1:32:17.940
and ethics questions rather than having a
General Counsel who has a number of jobs?

1:32:17.940,1:32:22.199
You don't have to answer that today but
I would like you to consider that. In so many

1:32:22.199,1:32:29.199
different HR situations in the private sector,
there is a clear independence of HR which

1:32:29.760,1:32:33.940
is a lot of the questions. A question of conflict
was more than a legal questions, particularly

1:32:33.940,1:32:40.789
when it included somebody who was the boss
of the person they went to for this 25 minute

1:32:40.789,1:32:44.940
session and clearance, so give that some thought.
I won't ask for an answer today.

1:32:44.940,1:32:46.900
[Ms. Schapiro] I will do that.

1:32:46.900,1:32:52.679
[Mr. Issa] Finally, as the time runs out,
we on the committee want to work to try to

1:32:52.679,1:32:57.010
be helpful. We realize we only have a portion
of the portfolio that you see; you see much

1:32:57.010,1:33:04.010
more of the regulatory and financial oversight
of another committee, but the question I have

1:33:04.260,1:33:11.260

for you is, in our conduct of this investigation Pg 54 of 73
as we look at Mr. Becker's total portfolio

1:33:11.369,1:33:17.760

of money, other things he may have done and
how this might have affected or not affected

1:33:17.760,1:33:21.340

the Madoff Trust, will you promise your cooperation
to this committee today?

1:33:21.340,1:33:26.349

[Ms. Schapiro] I will promise my cooperation
to the fullest extent I can. I don't know

1:33:26.349,1:33:28.489

that I can compel him in any way to do anything.

1:33:28.489,1:33:33.039

[Mr. Issa] He has already come in voluntarily.
We have the ability to compel him but it is

1:33:33.039,1:33:39.159

really making sure that we can have a quick
and transparent. Your IG would normally be

1:33:39.159,1:33:45.059

willing to share any information that was
not directly related to a criminal referral

1:33:45.059,1:33:49.679

and so on. Anything you can do to pledge to
help us will allow us to move from where we

1:33:49.679,1:33:53.210

are as quickly as possible onto something
else. That is why I ask today.

1:33:53.210,1:33:54.190

[Ms. Schapiro] Yes, of course I will help.

1:33:54.190,1:33:56.929

[Mr. Issa] Thank you. I thank you all for
your indulgence and I yield back.

1:33:56.929,1:33:58.159

[Mr. McHenry] Thank you.

1:33:58.159,1:34:00.190

Mr. Connolly of Virginia for five minutes.

1:34:00.190,1:34:03.249

[Mr. Connolly] Thank you, Mr. Chairman.

1:34:03.249,1:34:07.579

Chairman Schapiro, aren't you the Chairman
who appointed the Inspector General who, in

1:34:07.579,1:34:09.659

fact, is charged with investigating Mr. Becker?

1:34:09.659,1:34:13.019

[Ms. Schapiro] No, sir. He was appointed by
my predecessor.

1:34:13.019,1:34:15.999

[Mr. Connolly] By your predecessor. That investigation
continues?

1:34:15.999,1:34:20.249

[Ms. Schapiro] Yes. I requested the investigation.

1:34:20.249,1:34:22.880

[Mr. Connolly] You requested the investigation?

1:34:22.880,1:34:24.159

[Ms. Schapiro] Yes.

1:34:24.159,1:34:31.159

[Mr. Connolly] We just heard a line of questioning
asking you to look at a budget without additional

1:34:34.670,1:34:41.670
regulation that was burdensome and so forth.
The Dodd-Frank legislation added some regulation

1:34:45.559,1:34:49.389
in areas that heretofore had not been regulated
at all, is that correct, Chairman Schapiro?

1:34:49.389,1:34:50.940
[Ms. Schapiro] Yes, that is absolutely correct.

1:34:50.940,1:34:55.909
[Mr. Connolly] For examples, take derivates.
How big are derivates? What is the value of

1:34:55.909,1:34:56.829
the derivatives market?

1:34:56.829,1:34:59.119
[Ms. Schapiro] The last number I saw was \$600
trillion, I believe.

1:34:59.119,1:35:01.400
[Mr. Connolly] I am sorry, did you say trillion?

1:35:01.400,1:35:02.110
[Ms. Schapiro] Yes, sir.

1:35:02.110,1:35:06.449
[Mr. Connolly] It is entirely unregulated
until Dodd-Frank passed, is that correct?

1:35:06.449,1:35:08.449
[Ms. Schapiro] Yes, it is largely unregulated.

1:35:08.449,1:35:13.579
[Mr. Connolly] Whatever could go wrong with
an entirely unregulated \$600 trillion market?

1:35:13.579,1:35:19.229
[Ms. Schapiro] We saw some things that went
wrong and presumably that is what motivated

1:35:19.229,1:35:20.079
the Dodd-Frank Act.

1:35:20.079,1:35:24.320
[Mr. Connolly] So maybe that is one of those
burdensome additional pieces of regulation

1:35:24.320,1:35:31.320
we are just going to have to put up with.
That burdensome additional regulation requires

1:35:32.959,1:35:39.959
SEC to staff up and to acquire the requisite
expertise to enforce the regulation you are

1:35:40.119,1:35:41.630
now charged with, is that correct?

1:35:41.630,1:35:44.749
[Ms. Schapiro] Yes, we believe so. We are
able to do the rule writing that has been

1:35:44.749,1:35:48.659
ongoing this year but to operationalize those
rules, we need additional staff.

1:35:48.659,1:35:54.219
[Mr. Connolly] We heard Mr. Katz in his testimony
say that simply having more SEC staffers do

1:35:54.219,1:36:00.510
the same thing would not protect investors
or promote capital formation. How many areas

1:36:00.510,1:36:06.599
of additional or new regulation are requiring
you to ramp up in terms of expert staffing?

1:36:06.599,1:36:13.070

[Ms. Schapiro] We obviously have derivatives, hedge fund regulation, we are creating a new

1:36:13.070,1:36:19.239

whistleblower office although that is work that we need more help with but it is not

1:36:19.239,1:36:25.400

unknown to us. We have to increase our oversight of credit rating agencies under the Act and

1:36:25.400,1:36:29.610

we have to register a whole new category of registrant in the municipal securities markets

1:36:29.610,1:36:36.610

called municipal advisors, so there are half a dozen or so new areas for us to undertake

1:36:36.889,1:36:37.619

regulation.

1:36:37.619,1:36:44.019

[Mr. Connolly] Just listening to you tick off that list, none of those sound like frivolous

1:36:44.019,1:36:51.019

burdensome additional pieces of regulation. They sound like thoughtful additions to the

1:36:51.229,1:36:55.869

regulatory framework in light of the biggest meltdown on Wall Street in 80 years. Would

1:36:55.869,1:36:57.530

you share that view?

1:36:57.530,1:37:01.860

[Ms. Schapiro] I do think all of these areas are ones that needed to be addressed. As we

1:37:01.860,1:37:07.019

write the rules, we are working very hard in collaboration with other regulators, but

1:37:07.019,1:37:11.459

also with the public, with investors and the industry to make sure that we write as sensible

1:37:11.459,1:37:12.670

rules as we possibly can.

1:37:12.670,1:37:19.159

[Mr. Connolly] Mr. Katz, would you share that view or is this just another example of having

1:37:19.159,1:37:24.610

simply "more SEC staffers doing the same thing"?

1:37:24.610,1:37:29.999

[Mr. Katz] There is a quantitative nuance difference in what I said and the way I think

1:37:29.999,1:37:36.999

you characterized it. The agency has an enormously large number of new areas of regulatory authority.

1:37:41.209,1:37:47.010

The question is, when you go about regulating hedge funds, or regulating municipal securities

1:37:47.010,1:37:53.159

markets, are you going to regulate hedge funds exactly the way you regulate investment advisors,

1:37:53.159,1:37:57.989

which is arguably what they are, or investment companies, which is sort of a close cousin?

1:37:57.989,1:38:03.320

My point is that if you look at the way the Commission has regulated advisors, and regulated

1:38:03.320,1:38:09.499

mutual funds, it hasn't been terribly effective. If you take the same approach for hedge funds,

1:38:09.499,1:38:16.179

yes, that would be doing the same thing in those approaches, even if it is a new substantive

1:38:16.179,1:38:18.949

responsibility with a new category of registrant.

1:38:18.949,1:38:24.949

[Mr. Connolly] Would you say, Mr. Katz, that some of the problem preceding the Wall Street

1:38:24.949,1:38:30.479

meltdown in September 2008, for example, had to do frankly with the quality of the appointees,

1:38:30.479,1:38:34.050

namely a whole bunch of people who didn't believe in regulation in the first place and

1:38:34.050,1:38:34.849

therefore, didn't do it?

1:38:34.849,1:38:41.849

[Mr. Katz] I have to tell you that there is an old saying at the SEC that the Commissioners

1:38:48.749,1:38:55.749

decide the policy, but ultimately, it is the staff that decides what it means and how it

1:38:57.219,1:39:02.010

gets done. One of the interesting things about the SEC, the relationship between Commissioners

1:39:02.010,1:39:09.010

and the staff is that it is a close relationship. Because the Commission is a bipartisan body,

1:39:09.889,1:39:15.650

you are always going to get five people with diverging points of view, some of whom will

1:39:15.650,1:39:19.400

support the staff, some of whom will disagree with the staff.

1:39:19.400,1:39:25.550

I can't think of an occasion where you had five Commissioners on one side of the table

1:39:25.550,1:39:31.809

and the staff on the other side at loggerheads. That doesn't happen. You invariably get

1:39:31.809,1:39:35.869

some supportive of Commissioners, some Commissioners who are critical and you also get that divergence

1:39:35.869,1:39:39.329

of view among the staff.

1:39:39.329,1:39:42.969

Financial regulation is never a question of identifying a single right answer.

1:39:42.969,1:39:46.670

[Mr. Connolly] Thank you, Mr. Katz. Unfortunately, my time is up but I would love to pursue this

1:39:46.670,1:39:53.670

further, but I certainly believe that the narrative that somehow SEC is treading into

1:39:54.219,1:40:01.219

waters it has no business treading into is fallacious. If anything, we needed more people

1:40:01.729,1:40:06.340

guarding the hen house. If we are going to talk about the fox guarding the hen house,

1:40:06.340,1:40:10.519

that may have been true in the 2008 period of time but is not true today.

1:40:10.519,1:40:11.320

I thank the Chair.

1:40:11.320,1:40:15.650

[Mr. Katz] Excuse me, Mr. Chairman, if you might indulge me? There is one very quick

1:40:15.650,1:40:17.840

point I wanted to make that Mr. Yarmoth brought up.

1:40:17.840,1:40:18.150

[Mr. McHenry] Please.

1:40:18.150,1:40:23.639

[Mr. Katz] That was the question of the consolidated supervised entities regulatory process at

1:40:23.639,1:40:28.789

the SEC. There is a lot of confusion about that. There was a voluntary process. The reason

1:40:28.789,1:40:34.139

it was a voluntary process is not because of a deregulatory attitude at the SEC; it

1:40:34.139,1:40:40.809

is because the Commission sought from Congress the authority to make it a mandatory process

1:40:40.809,1:40:47.809

as part of the Gramwich Bill, which eliminated glass eagle.

1:40:48.809,1:40:55.229

Congress explicitly prohibited the Commission from making it a mandatory process. The Commission

1:40:55.229,1:40:57.989

had a weak hand, it played the weak hand as best it could.

1:40:57.989,1:40:59.570

[Mr. Platts] Thank the gentleman.

1:40:59.570,1:41:01.679

I will yield five minutes to myself.

1:41:01.679,1:41:07.199

I chair the Subcommittee on Government Organization, Efficiency and Financial Management, so I

1:41:07.199,1:41:14.199

am going to focus on a related but slightly different area that relates to our jurisdiction.

1:41:15.320,1:41:20.300

I had the privilege of chairing the same Subcommittee from 2003 to 2007.

1:41:20.300,1:41:26.749

We had a subcommittee hearing July 2003 about the SEC, about financial management at the

1:41:26.749,1:41:33.059

SEC, about internal controls and we heard testimony at that point they had just put

in a new financial management system in 2002.
In the testimony of the Executive Director,

1:41:39.190,1:41:45.699

James McConnor at the time in July 2003, he
said we have this new system and we are going

1:41:45.699,1:41:52.699

to be certified basically in January 2004
for audited financial statements. Here we

1:41:53.940,1:42:00.940

are seven years later, plus, and we are now
talking about the same thing, a new system

1:42:01.619,1:42:08.619

using DOT Enterprise system to put in place
a new system.

1:42:10.769,1:42:17.079

Chairman Schapiro, I appreciate the changes
you have made, the COO, the new Chief Operating

1:42:17.079,1:42:24.079

Officer and other leadership changes and systemic
changes within the SEC. Why should the American

1:42:24.979,1:42:30.679

people believe when we were told seven years
ago we got it right and we were going to be

1:42:30.679,1:42:32.289

able to go forward; how is it different today?

1:42:32.289,1:42:37.139

[Ms. Schapiro] Thank you. My understanding
is that was the Momentum system, I believe,

1:42:37.139,1:42:42.869

and it was deployed nine or ten years ago
and in the beginning, it did meet the agency's

1:42:42.869,1:42:49.010

needs, but then over time, the agency deferred
upgrading over many years and as a result,

1:42:49.010,1:42:54.289

it began to lack the functionality that was
necessary to do the job. Gaps were created,

1:42:54.289,1:43:01.289

work arounds were developed and as a result,
the SEC ended up with two material weaknesses

1:43:01.309,1:43:06.360

in its controls over financial reporting in
our audit which is a disgraceful position

1:43:06.360,1:43:09.800

for the Securities and Exchange Commission
to be in.

1:43:09.800,1:43:15.429

With our new Chief Operating Officer, our
new Chief Financial Officer and our new Information

1:43:15.429,1:43:20.559

Officer, we made the decision that rather
than incur the risks of developing a new system

1:43:20.559,1:43:26.619

at the SEC, perhaps not really a core competency
for us, that we would be better served by

1:43:26.619,1:43:28.659

outsourcing financial management.

1:43:28.659,1:43:33.900

We went through a process and identified the
Department of Transportation, which is an

1:43:33.900,1:43:39.699

authorized Federal Share Service provider
used by the GAO for their financial management

1:43:39.699,1:43:44.900

system, and made the decision that the best
way for us to remediate our material weaknesses,

1:43:44.900,1:43:49.550

generate the kind of reporting that we need,
minimize all these manual workarounds and

1:43:49.550,1:43:54.479

all of this would be to outsource to them.
I think it is the right decision for the taxpayer,

1:43:54.479,1:43:56.550

I think it is the right decision for the SEC.

1:43:56.550,1:44:01.650

[Mr. Platts] The follow-up related to that
is, in the audit that was done at the end

1:44:01.650,1:44:08.650

of this past year, a clean opinion, but failure
to sign off on the internal controls, two

1:44:09.449,1:44:11.119

related questions.

1:44:11.119,1:44:17.690

First, how would you describe the internal
effort to get the clean opinion other than

1:44:17.690,1:44:23.489

the internal controls and I ask in the sense
of in July 2003, SEC said it was a heroic

1:44:23.489,1:44:27.780

end of the year effort, it wasn't because
we had a system in place, here is the data,

1:44:27.780,1:44:32.780

we are ready to go. Was there again a heroic
end of the year effort to be able to have

1:44:32.780,1:44:33.150

that audit?

1:44:33.150,1:44:37.749

[Ms. Schapiro] I think there were some heroics
involved. I can't compare to 2003 but I

1:44:37.749,1:44:42.420

think we did put together a senior team of
people to really shepherd the process through.

1:44:42.420,1:44:47.059

They were diligent and they stuck with it,
but they are also very much onboard for this

1:44:47.059,1:44:48.940

decision to outsource.

1:44:48.940,1:44:55.530

[Mr. Platts] Interim controls, not until last
year in Dodd-Frank did it require the auditor

1:44:55.530,1:45:00.170

to sign off on the internal controls. For
almost 20 years under the Federal Managers

1:45:00.170,1:45:07.170

Financial Integrity Act adopted in 1982, actually
over 20 years, that we have to have strong

1:45:10.510,1:45:15.719

internal controls. Although that wasn't
required to be signed off, I assume you are

1:45:15.719,1:45:20.539

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really conscious of the fact that it wasn't
a new requirement that you have good internal

1:45:20.539,1:45:24.570

controls, it was just a new requirement that
it be signed off by the auditor and whoever

1:45:24.570,1:45:29.709

has been overseeing those internal control
systems, clearly were not fulfilling their

1:45:29.709,1:45:30.380

responsibilities?

1:45:30.380,1:45:36.670

[Ms. Schapiro] Absolutely, and under our Chief
Operating Officer, we will deal both with

1:45:36.670,1:45:40.170

the audit issues with respect to internal
controls, but also the attendant business

1:45:40.170,1:45:44.940

processes, so it is not just a technology
answer for us. It is going to have to be business

1:45:44.940,1:45:47.249

process, free engineering process as well.

1:45:47.249,1:45:51.349

[Mr. Platts] I am going to try to squeeze
in two more questions in 20 seconds.

1:45:51.349,1:45:57.900

In your testimony, you talk about the follow-on
person that you have for the audit recommendations

1:45:57.900,1:46:04.900

of your IG and GAO. In your testimony, you
state that you appointed an audit follow-up

1:46:05.940,1:46:10.479

official and empowered her to ensure that
agency managers are held accountable for timely

1:46:10.479,1:46:11.809

and appropriate follow up.

1:46:11.809,1:46:14.610

How are they being held accountable? One thing
that frustrates me is when we find something

1:46:14.610,1:46:19.630

that went wrong and I have asked for many
years now, was anyone disciplined, was anyone

1:46:19.630,1:46:24.840

fired for not doing what they were supposed
to do? In what way are they being held accountable?

1:46:24.840,1:46:28.929

[Ms. Schapiro] We are very closely tracking
audit recommendations, both from GAO and from

1:46:28.929,1:46:34.010

our Inspector General. I can tell you that
in my two years as Chairman, we have successfully

1:46:34.010,1:46:40.349

closed 350 Inspector General recommendations
compared to 190 in the prior two years. We

1:46:40.349,1:46:47.349

are aggressive about doing it and I will tell
you that in the Inspector General's semiannual

1:46:47.349,1:46:54.199

report, he also talks about our progress with
respect to closing recommendations and whether

1:46:54.199,1:46:59.099

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there has been any management disagreement
with his recommendations. He is quite on top

1:46:59.099,1:46:59.809

of it and quite transparent.

1:46:59.809,1:47:04.309

[Mr. Platts] I think that is critical going
forward. My subcommittee is especially going

1:47:04.309,1:47:09.619

to look at staying on top of those recommendations
and special internal controls. It goes to

1:47:09.619,1:47:14.400

the broader issue discussed here about ethics
and if you don't have internal controls,

1:47:14.400,1:47:19.440

that is the foundation for not just good financial
management, but for a good ethics environment.

1:47:19.440,1:47:20.440

[Ms. Schapiro] I agree completely.

1:47:20.440,1:47:25.780

[Mr. Platts] We, as a subcommittee, and partner
with Chairman McHenry here today, that is

1:47:25.780,1:47:27.119

what we are going to be looking at.

1:47:27.119,1:47:34.119

I will yield back and yield now to Ms. Speier
from California for five minutes.

1:47:38.659,1:47:40.469

[Ms. Speier] Thank you, Mr. Chairman.

1:47:40.469,1:47:44.119

I thank you all for your participation in
this hearing. I was particularly impressed

1:47:44.119,1:47:47.630

by the testimony of Mr. Katz and Mr. Crimmins.

1:47:47.630,1:47:54.630

I am somewhat surprised because I am looking
at the title of the hearing and the sign above

1:47:55.469,1:48:00.599

the Chairman's head that reads, "Can American
Taxpayers Trust Today's SEC to Manage Itself

1:48:00.599,1:48:07.599

and Do Its Job." I thought it might be interesting
to substitute Congress and ask the same question

1:48:08.579,1:48:12.719

and see if we would fare as well.

1:48:12.719,1:48:16.429

Chairman Schapiro, having served over two
years on the Financial Services Committee,

1:48:16.429,1:48:22.719

I have watched you and I think you are truly
committed to doing the right thing. Before

1:48:22.719,1:48:29.719

you came back as Chair, under Chairman Cox,
the number of actual enforcement actions at

1:48:32.179,1:48:37.709

the SEC was reduced by 80 percent and the
number of disgorgement actions were reduced

1:48:37.709,1:48:44.709

by 60 percent -- a stunning failure at a time
when all the mischief was going on with Wall

1:48:46.119,1:48:46.369
Street.

1:48:46.119,1:48:53.119
We look back at the savings and loan crisis
and we recognize that referrals from various

1:48:54.769,1:49:01.679
regulators, there were 10,000 of them, and
of those 10,000, there were 1,000 that turned

1:49:01.679,1:49:07.999
into convictions and 500 people went to jail.
These were CEO level folks that went to jail.

1:49:07.999,1:49:12.479
The American people are looking at us, looking
at Congress, looking at you and saying, who

1:49:12.479,1:49:19.479
is going to jail? Who is being charged? The
truth is there hasn't been a lot.

1:49:19.659,1:49:26.659
My first question is, have you made any referrals
to the Justice Department, to the U.S. Attorney,

1:49:26.900,1:49:29.090
as a result of the Wall Street meltdown?

1:49:29.090,1:49:33.679
Ms. Schapiro. I am confident that we have.
I guess I would like to supplement the record,

1:49:33.679,1:49:38.380
if I might, on that. I just don't know the
numbers or the details about it because, as

1:49:38.380,1:49:43.139
you know, we don't have criminal prosecution
authority, although we have continued to bring

1:49:43.139,1:49:49.030
a relatively high number of cases and some
very large impact cases coming out of the

1:49:49.030,1:49:50.689
financial crisis in the past year.

1:49:50.689,1:49:57.349
[Ms. Speier] So you will get back to the committee
and actually tell us how many referrals you

1:49:57.349,1:49:57.619
have made?

1:49:57.619,1:49:58.489
[Ms. Schapiro] I would be happy to.

1:49:58.489,1:50:05.489
[Ms. Speier] The CEO of Galian is being tried
now. Mr. Kupta who is a director of a significant

1:50:08.519,1:50:14.380
Wall Street firm, evidently is being looked
at as having shared insider information, although

1:50:14.380,1:50:18.639
he didn't appear to have acted on it. Have
any actions by the SEC been taken against

1:50:18.639,1:50:19.630
those two individuals?

1:50:19.630,1:50:26.630
[Ms. Schapiro] We filed a proceeding against
Mr. Kupta last week and we have filed multiple

1:50:26.829,1:50:31.269
proceedings coming out of the Galian investigation

1:50:31.269,1:50:31.789
so.

1:50:31.789,1:50:38.789
[Ms. Speier] In 2004 and 2005, the GAO said
to the SEC that it should take a look at and

1:50:40.530,1:50:47.260
close its revolving door. The SEC then reported
back to the GAO that it had done that, although

1:50:47.260,1:50:53.349
the GAO now says that never happened. The
reverse situation of Mr. Becker is the fact

1:50:53.349,1:51:00.349
that you have staff that work within the SEC
and then they are lured away by lucrative

1:51:01.840,1:51:08.170
salaries outside and oftentimes, the people
that are lured away are lured away by the

1:51:08.170,1:51:12.150
companies that they were actually investigating.

1:51:12.150,1:51:17.380
We need to do something about the lack of
a revolving door and I want to know, first

1:51:17.380,1:51:23.800
of all, have you made any policy changes in
an attempt to deter these revolving door practices?

1:51:23.800,1:51:30.599
[Ms. Schapiro] We have instituted requirements
that senior employees seek ethics counseling

1:51:30.599,1:51:37.599
before they leave the agency. We require all
employees to have a post employment briefing

1:51:38.070,1:51:42.380
so they don't violate ethics rules when
they are leaving. Of course we are subject

1:51:42.380,1:51:47.309
to the government-wide restrictions and we
have some unique to the SEC restrictions,

1:51:47.309,1:51:52.749
but our Inspector General in looking at a
specific revolving door incident has given

1:51:52.749,1:51:58.349
us last week some additional recommendations
for tightening up our rules. We are going

1:51:58.349,1:52:01.119
to look at those very seriously and I hope
to go forward with them.

1:52:01.119,1:52:08.119
[Ms. Speier] What about a cooling off period?
Why not require that persons within the Commission

1:52:08.579,1:52:15.579
that have the authority to make determinations
and were investigating are not allowed to

1:52:17.219,1:52:22.300
be hired by those who they have investigated
for a period of two years?

1:52:22.300,1:52:29.110
[Ms. Schapiro] I think there is a lot of appeal
to that. The only hesitation I have is that

1:52:29.110,1:52:33.959

we are so dependent on getting people to come Pg 65 of 73
to us, even if it is just for a few years

1:52:33.959,1:52:38.849
just to bring us current industry expertise,
we have to get the balance right.

1:52:38.849,1:52:42.170
[Ms. Speier] I don't disagree, because that
is precisely the problem.

1:52:42.170,1:52:45.539
[Mr. McHenry] The gentlelady's time has
expired.

1:52:45.539,1:52:50.139
I recognize myself for five minutes.

1:52:50.139,1:52:54.280
Chairman Schapiro, I want to get this out
of the way. I know there have been a number

1:52:54.280,1:53:01.280
of questions about the David Becker conflict
of interest question. I just have a couple

1:53:01.449,1:53:07.550
of questions, yes or no. I want to proceed
with it because I have some other issues I

1:53:07.550,1:53:10.389
do want to touch on beyond this.

1:53:10.389,1:53:16.849
After David Becker told you that he received
proceeds of a closed Madoff account, did you

1:53:16.849,1:53:20.869
suggest that he recuse himself from the Madoff
case, yes or no?

1:53:20.869,1:53:27.219
[Ms. Schapiro] I am sorry, the premise isn't
exactly right. My recollection is that he

1:53:27.219,1:53:34.219
told me that his mother had a Madoff account
before she died and that it had been closed.

1:53:35.880,1:53:42.030
I don't honestly recall whether he told
me he had received proceeds or not. He may

1:53:42.030,1:53:46.229
well have, I just can't recall. As you know,
I haven't been able to look at anything.

1:53:46.229,1:53:50.729
[Mr. McHenry] But he brought this up that
he received proceeds from a Madoff account?

1:53:50.729,1:53:54.239
[Ms. Schapiro] He brought up that his mother
had had a Madoff account.

1:53:54.239,1:53:58.380
[Mr. McHenry] In light of that, did you suggest
he recuse himself?

1:53:58.380,1:54:00.409
[Ms. Schapiro] No, I didn't.

1:54:00.409,1:54:06.229
[Mr. McHenry] Did you suggest that he settle
with the Trustee as other Madoff investors

1:54:06.229,1:54:07.199
were doing at the time?

1:54:07.199,1:54:08.820
[Ms. Schapiro] No.

1:54:08.820,1:54:15.059

[Mr. McHenry] Did you suggest that Mr. Becker disclose his interest to other SEC staff or

1:54:15.059,1:54:17.400

Commissioners who relied on his advice?

1:54:17.400,1:54:22.630

[Ms. Schapiro] I did not. I expected him to go to the Ethics Office and get ethics counsel

1:54:22.630,1:54:23.900

and follow their advice.

1:54:23.900,1:54:30.900

[Mr. McHenry] You are aware that the Ethics Counsel of the SEC reported to the General

1:54:31.639,1:54:31.889

Counsel?

1:54:31.639,1:54:34.559

[Ms. Schapiro] Yes, although the Ethics Officer is a career employee.

1:54:34.559,1:54:37.510

[Mr. McHenry] But his direct report.

1:54:37.510,1:54:38.989

[Ms. Schapiro] Yes.

1:54:38.989,1:54:43.550

[Mr. McHenry] Did you suggest that Becker do any research to determine the amount or

1:54:43.550,1:54:46.280

the character of interest that he had?

1:54:46.280,1:54:47.110

[Ms. Schapiro] No.

1:54:47.110,1:54:53.570

[Mr. McHenry] Later when Becker was providing advice about the net equity evaluation method,

1:54:53.570,1:54:59.530

did you direct Mr. Becker to take any actions with respect to this potential conflict of

1:54:59.530,1:54:59.780

interest?

1:54:59.530,1:55:03.670

[Ms. Schapiro] No, because it didn't occur to me that this long ago closed account would

1:55:03.670,1:55:06.110

be in any way impacted, it just didn't occur to me.

1:55:06.110,1:55:10.179

[Mr. McHenry] So he didn't disclose to you that he was, in fact, the trustee who closed

1:55:10.179,1:55:11.429

the account?

1:55:11.429,1:55:12.849

[Ms. Schapiro] I don't recall.

1:55:12.849,1:55:19.070

[Mr. McHenry] I understand. I am just trying to get to the heart of this. This raises major

1:55:19.070,1:55:26.070

questions and I think you can understand the public's interest and the investors' interest.

1:55:26.920,1:55:33.920

To that same degree, when Mr. Becker was filing

briefs in court that took recommendations Pg 67 of 73

1:55:34.510,1:55:40.689
in terms of the net equity position valuation
method, you didn't direct Mr. Becker to

1:55:40.689,1:55:41.159
recuse himself?

1:55:41.159,1:55:41.900
[Ms. Schapiro] No.

1:55:41.900,1:55:46.969
[Mr. McHenry] Okay. I just wanted to get those
out of the way. Obviously we care deeply about

1:55:46.969,1:55:52.679
transparency and disclosure both here in Congress
and with regulators.

1:55:52.679,1:55:59.679
Chairman Schapiro, Mr. Risinger, thank you
for your public service, but we need to get

1:56:03.559,1:56:08.340
to the heart of this issue. I think that is
why we are asking these questions today and

1:56:08.340,1:56:08.880
why I am.

1:56:08.880,1:56:12.329
[Ms. Schapiro] I agree, Mr. Chairman. It is
why I have asked the Inspector General to

1:56:12.329,1:56:14.380
do a review, so we can get all the information.

1:56:14.380,1:56:20.840
[Mr. McHenry] The point is you said you wish
you had known then what you know now and had

1:56:20.840,1:56:27.239
you asked any of these questions, you would
have known it then. That is at the heart of

1:56:27.239,1:56:34.239
this issue. That is what is disappointing
and of great concern in terms of public policy.

1:56:37.699,1:56:44.699
Ms. Chaitman, in dealing with this Madoff
valuation question, I understand the insurance

1:56:45.469,1:56:52.469
piece, I do, would it have changed your dealings
with SEC's legal counsel had you known that

1:56:53.719,1:56:56.849
Mr. Becker was the trustee of a Madoff account?

1:56:56.849,1:57:03.849
[Ms. Chaitman] If I had know that, I would
have, myself, demanded that he recuse himself

1:57:04.610,1:57:11.610
and that the SEC take steps to clarify its
position because as I say, both Congressman

1:57:12.459,1:57:17.809
Garrett and I believe that the SEC has taken
an illegal position in supporting SIPC. If

1:57:17.809,1:57:22.360
I had know that Mr. Becker had a personal
interest, I certainly would have asked Ms.

1:57:22.360,1:57:22.780
Schapiro to do something about it.

1:57:22.780,1:57:24.949

[Mr. McHenry] Thank you.

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1:57:24.949,1:57:30.329

Mr. Katz, this raises a larger management issue. We are talking about capital formation,

1:57:30.329,1:57:35.889

we are trying to be the world's markets, which we have been. When you have a dysfunctional

1:57:35.889,1:57:42.889

agency like this with these management problems that you described, you said the SEC has never

1:57:46.400,1:57:51.439

engaged in serious self examination of its performance or used appropriate measures of

1:57:51.439,1:57:53.389

performance. Is that still the case?

1:57:53.389,1:58:00.389

[Mr. Katz] Not having seen this Boston consulting group report that is apparently due out, I

1:58:00.900,1:58:05.519

think yes, that is the case. It has been a long time since the agency took a hard look

1:58:05.519,1:58:06.590

at itself in the mirror.

1:58:06.590,1:58:11.130

[Mr. McHenry] My time has expired. With that, I recognize Ms. Maloney for five minutes.

1:58:11.130,1:58:16.869

Votes have been called on the Floor, we have 11 minutes remaining in the votes, so I would

1:58:16.869,1:58:21.889

defer to my colleagues on that side of the aisle if they want to work something out in

1:58:21.889,1:58:23.469

terms of time.

1:58:23.469,1:58:30.469

The gentlelady is recognized now for five minutes.

1:58:34.789,1:58:37.510

*Mrs. Maloney. First of all, I would like to welcome all the panelists and thank the

1:58:37.510,1:58:43.599

Chairman for this important hearing. Certainly honesty and transparency is very important

1:58:43.599,1:58:44.309

in government.

1:58:44.309,1:58:51.309

I would like to get further clarification from Chairman Schapiro. As I understand, the

1:58:51.860,1:58:58.860

controversy around Mr. Becker's alleged conflict of interest is about an SEC decision

1:59:00.019,1:59:07.019

that appears to be against his financial interest. As I understand it, prior to Mr. Becker's

1:59:09.769,1:59:14.400

return to the SEC, he was working at a private law firm, correct?

1:59:14.400,1:59:16.989

[Ms. Schapiro] Yes, he was.

1:59:16.989,1:59:23.989

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*Mrs. Maloney. When he arrived at the SEC,
you testified he took steps to notify both

1:59:24.739,1:59:31.739

you and the SEC's Ethics Counsel of his
inheritance from his mother which had been

1:59:32.570,1:59:38.650

liquidated long before Madoff's ponzi scheme
had been discovered, correct?

1:59:38.650,1:59:41.090

[Ms. Schapiro] That is my understanding.

1:59:41.090,1:59:47.499

*Mrs. Maloney. The ethics official said it
was okay for him to work on Madoff-related

1:59:47.499,1:59:52.360

issues. That is what is in the memo and information
that I read, that the Ethics Committee is

1:59:52.360,1:59:57.579

there to be consulted, he consulted them and
they said there was no conflict, that is fine,

1:59:57.579,2:00:00.689

go to work. Is that your recollection?

2:00:00.689,2:00:02.030

[Ms. Schapiro] Yes, I believe.

2:00:02.030,2:00:06.729

*Mrs. Maloney. Your memory is the same as
the Ethics Committee. Chairman Schapiro, it

2:00:06.729,2:00:13.729

appears that the basic question the SEC faced
was whether to support an asset valuation

2:00:15.420,2:00:22.420

method used by the Madoff Trustee called the
cash-in, cash-out method, or a different evaluation

2:00:24.420,2:00:30.539

method used by several law firms called the
last statement method. Is that correct?

2:00:30.539,2:00:31.519

[Ms. Schapiro] Yes.

2:00:31.519,2:00:38.519

*Mrs. Maloney. Under the first method, Mr.
Becker's inheritance would be subject to

2:00:39.019,2:00:46.019

clawback litigation and under the second method,
his inheritance would not have been subject

2:00:46.920,2:00:53.920

to clawback. The SEC choose to support the
first, the decision was against the financial

2:00:55.979,2:01:02.979

interest of Mr. Becker. This meant that the
Trustee could sue Mr. Becker and his brothers

2:01:03.280,2:01:08.130

to recover some of his mother's inheritance
which is exactly what happened, correct?

2:01:08.130,2:01:14.159

[Ms. Schapiro] That is right. The SEC did
take the position that was cash-in, cash-out

2:01:14.159,2:01:21.159

in constant dollars to reflect that some very
elderly people who had long held Madoff accounts

2:01:21.539,2:01:27.360

would be able to get some more money from Pg 70 of 73
SIPC under that formulation, but it was not

2:01:27.360,2:01:34.360
the final statement approach that you mentioned
that would have potentially prevented the

2:01:35.829,2:01:36.209
clawback.

2:01:36.209,2:01:43.209
*Mrs. Maloney. But the decision was to allow
the clawback, so I assume he participated

2:01:43.559,2:01:46.599
in a decision allowing the clawback that was
against his financial interest?

2:01:46.599,2:01:51.969
[Ms. Schapiro] The decision to clawback is
one of the Trustee, not of the SEC.

2:01:51.969,2:01:55.780
*Mrs. Maloney. The SEC did not make that decision,
the Trustee made that decision?

2:01:55.780,2:01:56.969
[Ms. Schapiro] The Trustee makes that decision.

2:01:56.969,2:02:02.959
*Mrs. Maloney. The Trustee makes that decision,
but it was a decision that affected Mr. Becker.

2:02:02.959,2:02:03.789
[Ms. Schapiro] Yes.

2:02:03.789,2:02:10.789
*Mrs. Maloney. I would like either you or
Mr. Crimmins to answer. Basically, Mr. Becker

2:02:12.369,2:02:19.369
or the SEC sided with the Madoff Trustee.
The SEC actually took action that was potentially

2:02:20.219,2:02:26.429
detrimental to Mr. Becker's financial interest
and it exposed him to a potential litigation

2:02:26.429,2:02:33.429
worth roughly \$1.5 million because that was
the proceeds, correct, in addition to the

2:02:33.499,2:02:40.479
\$500,000. Everybody seems to be criticizing
Mr. Becker, but Mr. Becker and the SEC's

2:02:40.479,2:02:45.369
decision appears to have been completely against
his financial interest.

2:02:45.369,2:02:50.510
I understand you have an IG report coming
out and that eventually will clarify things

2:02:50.510,2:02:57.510
more, but in first reading the information,
it appears that the decision made was against

2:02:58.459,2:03:04.559
him and against his financial interest and
what he or the SEC thought was the right way

2:03:04.559,2:03:04.809
to go.

2:03:04.780,2:03:11.780
If the SEC had supported the banks' interpretation
or the law firm's interpretation instead

2:03:14.969,2:03:21.530
of the Trustee's interpretation, Mr. Becker

might not have had any exposure at all, is Pg 71 of 73

2:03:21.530,2:03:25.829
that correct? Mr. Crimmins?

2:03:25.829,2:03:32.829
[Mr. Crimmins] The point is that the \$500,000
that Dorothy Becker invested was going to

2:03:34.809,2:03:41.429
come back. The \$1.5 million, as you indicated,
was the Madoff fictitious profit was going

2:03:41.429,2:03:47.999
to Picard's claim as the Trustee, independent
reporting to the court, not to the SEC, that

2:03:47.999,2:03:52.729
dealt with a little bit of difference is whether
there should be some modest rate of return,

2:03:52.729,2:03:56.039
whether there should be some adjustment for
inflation.

2:03:56.039,2:04:00.570
That is still not finally determined. A month
after Becker has left the agency, it is a

2:04:00.570,2:04:05.949
small amount and to an individual who was
compensated at \$3 million a year, roughly,

2:04:05.949,2:04:11.300
and gave that up to go work in the public
service, it is totally inconsequential and

2:04:11.300,2:04:16.199
I would respectfully submit to the Subcommittee,
be a distraction.

2:04:16.199,2:04:21.389
*Mrs. Maloney. May just complete with one
observation for two seconds.

2:04:21.389,2:04:27.369
Basically, if someone in Mr. Becker's position
wanted to help himself financially, he would

2:04:27.369,2:04:32.510
have taken the opposite point of view than
the one that he took or the one that the SEC

2:04:32.510,2:04:32.829
took.

2:04:32.829,2:04:36.199
[Mr. McHenry] The gentlelady's time has
expired. We have votes on the Floor, Madam.

2:04:36.199,2:04:38.219
*Mrs. Maloney. I look forward to the IG's
report.

2:04:38.219,2:04:45.219
[Mr. McHenry] I think we all do. I appreciate
the gentlelady wrapping up. We do have votes

2:04:45.219,2:04:45.610
on the Floor.

2:04:45.610,2:04:46.719
I want to thank the panel.

2:04:46.719,2:04:51.429
[Ms. Schapiro] Mr. Chairman, I am so sorry,
I wanted to just say one thing. I want to

2:04:51.429,2:04:55.919
make it very clear, I don't recall specifically
whether Mr. Becker told me he had inheritance

2:04:55.919,2:05:02.599
from the account or whether his mother had
had an account and I made that assumption.

2:05:02.599,2:05:06.900
Because it is two years ago, I just don't
recall. I want to be so clear about that.

2:05:06.900,2:05:10.959
[Mr. McHenry] We will let the record reflect
that.

2:05:10.959,2:05:12.539
[Ms. Schapiro] Thank you.

2:05:12.539,2:05:19.090
[Mr. McHenry] Certainly. I think it is important
the record accurately reflect what happened.

2:05:19.090,2:05:23.669
The findings of this hearing are very important.
We are interested in management issues. The

2:05:23.669,2:05:30.669
members certainly took a specific direction
today dealing with this conflict of interest

2:05:30.679,2:05:37.679
of Mr. Becker, the General Counsel for the
SEC because of the fact he was a trustee of

2:05:38.150,2:05:45.150
a Madoff account a few years before, and the
decision, as Ms. Chaitman mentions, that was

2:05:46.039,2:05:53.039
a very different valuation than was existent
under law and the decision he made that in

2:05:56.459,2:06:02.340
some ways benefited him disproportionately
than the other two methods.

2:06:02.340,2:06:09.340
In terms of the budget, I think it is appropriate
that SEC have a sufficient budget and we have

2:06:10.610,2:06:15.610
strong management practices to make sure there
is transparency and disclosure, safety and

2:06:15.610,2:06:19.150
soundness in investing in our markets.

2:06:19.150,2:06:26.139
In the wake of the Enron scandal, in February
2003, the SEC was given the largest spending

2:06:26.139,2:06:33.139
increase in its history. The GAO said in testimony
before this subcommittee in 2003, it was a

2:06:33.239,2:06:40.239
45 percent increase at that time. This was
supposed to prevent a future crisis, yet Madoff

2:06:41.749,2:06:48.749
still occurred and the excuses cannot always
be based on money. We would ask that we tighten

2:06:50.139,2:06:56.300
up management practices, do what is appropriate
in terms of bringing technology to the fore

2:06:56.300,2:07:02.979
and do the best possible of any regular.

2:07:02.979,2:07:09.979
It isn't wrong to use a crisis to request
more. It is wrong to use a crisis just to

2:07:10.320,2:07:16.300

request more money. So with that, the committee stands adjourned. Thank you for your testimony.

2:07:16.300,2:07:16.550

[Whereupon, at 3:40 p.m., the subcommittee was adjourned]